ROOM DOCUMENT 4

Framework Paper on Regulatory Innovation

How innovation in the design and delivery of regulatory services can promote and support innovation in the economy.

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The OECD is developing an Observatory of Public Sector Innovation. The Observatory aims to systematically collect, categorise, analyse and share innovative practices from across the public sector, via an online interactive database. The Regulatory Policy Committee has been invited to collect and contribute examples of innovative practices in the field of regulatory policy to the Observatory. This paper lays out a framework for thinking about innovation in the design and delivery of regulatory services. Delegates are invited to consider and comment on the framework and the paper, and to submit examples of innovative practices that can be reflected in a future draft version of this paper, and feature in the OECD Observatory of Public Sector Innovation. Comments and submissions should be sent by email to gregory.bounds@oecd.org by 21 January 2013.

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Summary

1. The OECD Innovation Strategy argues that innovation will become an increasingly important source of productivity gains and economic growth in coming years. Moreover, restoration of the economy to a high growth path is essential to enable governments to respond successfully to the pressures the currently face, such as climate change, health, food security and access to clean water.

2. This means that Member countries must ensure that their policy settings encourage innovation in a wide range of contexts. The strategy also emphasises that innovation is increasingly understood more broadly than before: previously understood largely in terms of scientific or technological advance, innovation is now increasingly seen as "the introduction of a new or significantly improved product, process or method".

3. Within this context, innovation in the use of the regulatory tool by governments can potentially make a substantial contribution. The opportunity for regulatory innovation arises at all stages of the regulatory cycle. Thus:
   
   - At the problem definition stage, innovation involves a focus on better ways of measuring the risks giving rise to the policy issue and more consistent assessments of the case for intervention.
   
   - At the regulatory design and development phase, innovation relates both to the regulatory and other policy tools being adopted and the processes by which the design of the policy intervention is finalised.
   
   - Innovations in regulatory implementation and enforcement have included the adoption of risk based approaches to inspection and audit activity and moves to broaden the range of sanctions available for regulatory breaches and apply them in a structured fashion.
   
   - Potential innovation in regulatory review and reform includes both the adoption of better targeted regulatory review strategies at the "macro" level, as well as better methods of conducting regulatory evaluations at the level of individual piece of legislation or regulatory structures.

4. This paper sets out a framework for assessing the potential contribution of innovations across the regulatory cycle, as well as providing a number of examples of promising innovations adopted by one or more Member governments in recent years and links to additional information on these innovations. The framework adopted is consistent with the general approach taken to the consideration of regulatory policy, which focuses on regulatory policies, tools and institutions. In broad terms:
   
   - Innovation in regulatory policy seeks to better direct regulatory resources and, in particular, ensure that regulatory reform activity is focused on its highest value uses;
   
   - Innovation in relation to regulatory tools is of particular importance to their ability to maximise the quality of new regulation during the development phase; and
• Innovation in regulatory institutions seeks to improve the quality of regulatory administration and enforcement.

5. An additional, developing dynamic identified is that of rapidly increasing adoption of various kinds of "private regulation". While this phenomenon has many elements, two core dynamics in this regard are that:

• consumers are increasingly seeking to influence the achievement of broader social goals by choosing among products partly on the basis of issues relating to how the products are made, such as the labour and environmental standards achieved, rather than simply the product's intrinsic attributes; and

• as a consequence, sellers are increasingly seeking to regulate these elements of the production processes of their suppliers.

6. These dynamics have the potential to have both positive and negative impacts in terms of the objectives of the regulatory quality agenda. More broadly, they have potential implications for the need for, and extent of, government regulatory intervention in many areas, as well as the optimum form of government intervention. Governments appear to have taken few steps toward understanding the implications of these changes to date, suggesting an important area for further research and regulatory innovation.

7. Finally, there is an increasing recognition of the fact that governments inevitably engage in a high level of regulatory activity within their own administrations and that these activities are subject to many of the same incentives and pitfalls as regulation directed beyond government. This implies that many of the disciplines developed as part of the regulatory policy agenda are potentially applicable to this "internal" regulation. The limited action taken in this area to date suggests that this too constitutes a potentially important area for future regulatory innovation.
TEMPLATE FOR COLLECTING “REGULATORY INNOVATIONS”

The Secretariat invites examples of regulatory innovations from countries that can be reflected in a future draft version of this paper, and feature in the OECD Observatory of Public Sector Innovation. Submissions, addressing the topics below, should be sent by email to gregory.bounds@oecd.org.

1. Category of innovation

Please indicate whether this innovation relates to regulatory policies, tools or institutions. Please note also at which stage(s) of the regulatory cycle (i.e. problem definition, regulatory design and development, regulatory implementation and enforcement, regulatory review and reform) the reform is intended to operate.

2. Description of the innovation

Please provide a brief description of the innovation, highlighting:

- the authority under which it is made (e.g. law, lower level rule, Presidential Decree, administrative rule);
- parties responsible for its implementation;
- timeframe for implementation;
- resources required for/devoted to implementation.

3. Background to, and objective of, the innovation

Please explain how the innovation came about, including who was responsible for its design and development, what circumstances gave rise to the initial reform proposal and over what time-frame the reform proposal was developed and approved.

Please state the objective of the innovation as specifically as possible and discuss its relationship to other key regulatory policy initiatives.

4. Outcomes of the innovation

Please provide any available data or other evidence of the impact of the innovation. Please also provide a qualitative assessment of the impact of the innovation, highlighting:

- The current stage of implementation & expected time for completion (if applicable);
- Any modifications made to the innovation as a result of experience with its implementation;
- Whether the innovation continues to be pursued, or has been terminated;
- In the case of discontinued innovations, what led to their discontinuation, and what lessons were learned;
- What were the views of key stakeholders regarding the innovation.

5. Resources

Please provide relevant references, website links, and/or contact details of officials with knowledge of the innovation, for the benefit of regulatory policy officials seeking further information on the innovation.
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1. Regulatory Innovation and the OECD Innovation Strategy

8. The OECD published its innovation strategy in 2010\(^1\). A key theme of the strategy is that innovation is becoming progressively more important as a source of economic growth and productivity gains, in a context in which other, traditionally important contributors to these outcomes - such as population growth and capital investments - are declining in importance. This means that strong innovation performance will, in the future, increasingly be a determinant of countries' economic success. Indeed, the innovation strategy points out that innovation is already central to economic performance:

   *Innovation is already an important driver of growth in some countries. Firms in several OECD countries now invest as much in intangible assets, such as research and development (R&D), software, databases and skills, as in physical capital, such as equipment or structures. Much multifactor productivity (MFP) growth is linked to innovation and improvements in efficiency.* (OECD, 2010, p 9).

9. The current context is one in which governments are facing significant social pressures such as climate change, health, food security and access to clean water, many of which are global in nature or require global action. The restoration of the economy to a high growth path is essential to enable them to respond successfully to these pressures.

10. The Strategy also highlights the fact that "innovation" is increasingly understood to embrace a wider range of factors than was traditionally the case. Whereas the concept of innovation has previously been understood largely in terms of scientific or technological advance, the strategy proposes that innovation should be understood as constituting "the introduction of a new or significantly improved product, process or method".

11. This broader understanding of the concept of innovation in turn implies that governments have a larger role in both adopting innovative approaches in their own activities and in promoting and supporting innovation in the economy more generally. In the former context, the strategy notes that there is considerable scope to improve the efficiency of government spending and to innovate in the delivery of public services.

12. Similarly, there are many policy actions that government can take to help strengthen innovation that require little or no additional public investment. Among these potential reforms to the framework conditions that support innovation within the economy, a central element is that of regulatory innovation and reform. The removal of regulatory barriers to innovation and entrepreneurship, including administrative regulations, as well pro-growth tax reforms, can do much to strengthen innovation and growth. The strategy notes that, in most OECD countries, there is significant potential for markets to be strengthened to unleash demand for innovative products and services that meet social and global needs. Regulatory innovation in this context involves opening markets to greater competition and ensuring that regulations and technical standards enable, rather than inhibit innovation in products and services.

13. The impact of regulation on entrepreneurial activity is an area of particular importance: entrepreneurs are particularly important actors in innovation, as they help to turn ideas into commercial applications. The strategy highlights the kinds of regulatory reforms that can favour innovation in this regard:

"Simplifying and reducing start-up regulations and administrative burdens can reduce barriers to entry. Bankruptcy laws should be less punitive for entrepreneurs and should offer more favourable conditions for the restructuring of ailing businesses, with due regard to risk management and the need to avoid moral hazard" (p 12).

14. Moreover, market failures – including the simple absence of a market – limit investment and the development and deployment of innovations. Thus, regulation that addresses these market failures, for example by pricing externalities, can act as an important trigger for innovation. Tax policies or other economic instruments can also help provide price signals that encourage innovation, provide the necessary signal and thus foster a market for innovations.

15. In sum, regulatory innovation is, as the above discussion suggests, capable of making a significant contribution to the achievement of the OECD Innovation Strategy's broad vision of the future role of innovation in serving public policy outcomes in OECD countries. The issue of regulatory innovation has two core elements:

- Reforming regulation to ensure that regulatory impediments to innovative activity in the private sector are minimised; and
- Implementing innovations within the regulatory context itself to enable government to achieve its regulatory goals more effectively and at lower cost to both itself and to regulated parties (i.e. the economy generally).

16. This paper highlights a range of recent and emerging regulatory innovations, discussing their key characteristics and providing key examples of their practical application where possible.

2. Regulatory innovation and the stages of the regulatory cycle.

17. The "regulatory cycle" comprises four main stages. These are:

- defining policy problems and assessing the case for regulation;
- regulatory design and development;
- regulatory implementation and enforcement; and
- regulatory review and reform.

18. Particularly in light of the innovation strategy's stress on the need for a broad view to be taken of what constitutes innovation and how it can be applied, governments should seek opportunities for regulatory innovation at all stages of this cycle.

19. At the problem definition stage, innovation involves a focus on better ways of measuring the risks giving rise to the policy issue and more consistent assessments of the case for intervention. The benefit of better practice here is to ensure systematically that more consistent results are achieved in terms of decisions as to whether and when to undertake government policy action. An example, is the United Kingdom government's Health and Safety Executive's guidance on risk assessment in the context of decision-making on whether intervention is justified. This material includes the use of benchmark quantitative risk levels. While it has been used in the UK for several years, it appears to remain the only
instance of the use of such generally applicable quantitative guidance in this context in OECD member countries.

20. At the regulatory design and development phase, innovation relates both to the regulatory and other policy tools being adopted and the processes by which the design of the policy intervention is finalised. Innovation in relation to regulatory tools implies the adoption of different forms of regulation, the use of new policy tools either as alternatives to regulation or complements to it, and the application of different tools to particular policy contexts. In addition, innovation in relation to processes involves both policy processes within government and, in particular, improved practices in relation to consultation and impact assessment (i.e. the "interactive" aspects of policy development).

21. Innovations in regulatory implementation and enforcement have included the adoption of risk based approaches to inspection and audit activity and moves to broaden the range of sanctions available for regulatory breaches and apply them in a structured fashion. These have been adopted in several countries in recent years, with prominent examples being the reforms adopted in the United Kingdom in response to the Hampton and McCrory Reports. These are discussed further in the next section. The focus of innovation in these areas is on improving efficiency in the use of regulators’ resources by better directing supervisory activities and by creating better incentive structures.

22. Potential innovation in regulatory review and reform includes both the adoption of better targeted regulatory review strategies at the "macro" level, as well as better methods of conducting regulatory evaluations at the level of individual piece of legislation or regulatory structures.

3. A taxonomy of regulatory innovation: Policies, tools and institutions

23. Much of the OECD’s work on regulatory governance uses the taxonomy of regulatory policies, tools and institutions to describe the scope of activity that must be addressed if systematic attempts are to be made to optimise the use of the regulatory tools of government. This taxonomy can therefore be used effectively to present the range of areas of actual or potential regulatory innovation.

3.1. Innovations in relation to regulatory policies

3.1.1. Strategies for review of existing regulation.

24. The OECD’s work on regulatory policy has identified a range of strategies for review of existing regulation and the characteristics, strengths and weaknesses of each. A basic distinction is between generalised reviews and sector-specific approaches. In the former case, the entire regulatory structure is required to be assessed against broad criteria such as need and efficiency. Conversely, sector-specific approaches are based on the identification of high-priority areas for reform, often as the result of strong stakeholder lobbying, or initial research by regulatory reform authorities. The benefits accruing from these approaches are necessarily fundamentally dependent on the quality of the priority-setting process that leads to identification of the sectors to be reviewed.

25. Generalised reviews are often favoured in the early stages of the adoption of a regulatory policy, by governments ambitious to make rapid progress on reform. However, they have often absorbed substantial resources while delivering limited result. Key problems include the ability of strong lobby
groups to obtain exemptions from the process, often for regulation most in need of reform, and the lack of rigor and depth in reviews that can be an almost unavoidable result of the size of the task undertaken.  

26. Conversely, an uncommonly successful example of a generalised review is the Australian National Competition Policy Review. This, multi-faceted review program extended over more than a decade, until the mid-2000s, and included a program of identification and review of all legislation that contained significant restrictions on competition. A 2005 review found that it had delivered substantial benefits, which greatly outweighed the costs incurred. These included contributing to a major rise in productivity and economic growth, reducing the price of many goods and services, stimulating business innovation, consumer responsiveness and choice and helping to meet some environmental goals.

27. This approach, while apparently highly successful in Australia, does not appear to have been adopted in other OECD countries, at least as an explicit and wide-ranging reform program. However, more recent work by the OECD has sought to provide a basis for the systematic assessment of the competition implications of new regulatory proposals. The Competition Assessment Toolkit is designed to enable non-specialists in the competition policy field to identify potentially significant competition issues via a simplified question set and to provide guidance on how proposals can be modified to reduce or eliminate anti-competitive aspects while continuing to meet the underlying policy objective. The Toolkit is available in a wide variety of languages and is intended to bring together RIA and competition assessment, in countries where RIA is practised.

28. Moreover, the Toolkit gave rise, in 2009, to the OECD Council's Recommendation on Competition Assessment. The Recommendation calls for governments to identify existing or proposed public policies that unduly restrict competition and to revise them by adopting more pro-competitive alternatives. The Recommendation calls for governments to establish institutional mechanisms for undertaking such reviews.

3.1.2. Inter-governmental co-operation on reform programs

29. The previous section has highlighted moves to broaden the regulatory reform agenda across levels of government in some countries, in recognition of the potential for the benefits of reform achieved at one level to be undermined by negative developments - or indeed inaction - at other levels. One, high level context for this inter-governmental co-operation is that of co-ordination of the broad regulatory reform program. An innovative example of sustained inter-governmental co-operation in this area comes from Australia.

30. The Council of Australian Governments (CoAG) had previously agreed the National Competition Policy as a joint Federal/State Government reform initiative and, as a follow-up initiative, in 2008 adopted a "National Partnership Agreement to Deliver a Seamless National Economy." This constituted an initial agreed list of 36 major reform areas to be pursued via co-ordinated programs of action over a multi-annual timeframe. These included 27 deregulation priorities, eight areas of competition reform and a reform to

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5 See: http://www.oecd.org/daf/competition/competitionassessmenttoolkit.htm

6 http://www.oecd.org/daf/competition/oecdrecommendationoncompetitionassessment.htm

7 See: http://www.coag.gov.au/a_seamless_national_economy. This includes links to material on the specific areas of reform being pursued, the outputs and outcomes of reform and the implementation plans adopted.
regulation making and review processes. As of May 2012, 17 of the deregulation priorities and two of the competition reforms are operational.

31. The underlying rationale for this approach lies in recognition of the potential for much greater economic benefits to be attained nationally if consistent reforms are adopted across the country, rather than the alternative of individual States determining their own, inevitably divergent, reform agendas. The Productivity Commission, the Federal Government's key source of advice on micro-economic reform, has estimated that that the 17 reforms that it modelled could increase GDP by around 0.4 per cent (over A$6 billion) per year and reduce business costs by around $3 billion per year. Given these benefits, the Federal Government undertook as part of the partnership agreement to make financial payments to participating State/Territory governments. This approach draws on earlier experience in implementing the National Competition Policy reforms, where such contingent payments were found to be significant in ensuring the delivery of reform outcomes.

3.1.3. Red tape reduction policies.

32. Policies that are specifically oriented toward red tape reduction have become an integral part of the regulatory policy agenda in the majority of OECD countries over the past decade. These policies seek to improve regulatory efficiency by reducing the administrative compliance costs associated with regulation without affecting the achievement of the underlying regulatory benefits. Most countries have based their policies on the adoption of methodologies based on the Standard Cost Model (SCM) and the adoption of successive, cross-government burden reduction targets, as shown by the fact that the majority of OECD countries are numbered among the 29 countries that from the Standard Cost Model Network.

33. Notwithstanding this high degree of commonality in approaches to red tape reduction, some innovations can be identified. In particular Denmark, which is numbered among the members of the SCM network, has adopted an approach known as the "Burden Hunting Technique". The essence of this innovation, commenced in 2007, is that it has been developed to provide the basis for involving regulated parties more extensively in administrative burden reduction programs, an approach referred to as "user-centric innovation". According to the Danish government:

*User-centric innovation of business regulations means that enterprises themselves will be at the centre of ministerial initiatives for cutting red tape. The enterprises will play an active role in identifying potentials for the rethinking of business regulations, and will be involved in the practical realization of these potentials. The focus is on the enterprises’ experience of business regulations and on how these burdensome experiences can be reduced.*

34. This high level of involvement of regulated parties constitutes the key innovation of this project. The concept involves working with a small sample from the regulated group, first using site visits to try to identify issues and priorities for regulatory reform. An analytical phase then leads to the development of potential solutions, which are subsequently "concept tested" with the sample group, enabling the proposals to be refined and improved. A final phase involves communicating the outcomes of the project back to the participant group.

35. According to a 2009 World Bank review "An interesting conclusion has been that at times, it is not the concrete burden that is annoying—but the way the obligation is constructed. The perception

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8 See: www.administrative-burdens.com, the website of the SCM Network, for further information and resources on the adoption of this methodology.

9 See: http://www.regelforenkling.dk/graphics/Regelforenkling/The_burden-hunting_technique.pdf
becomes that the burden is senseless”

"Irritation from experiences with regulation and frontline service can account for a significant degree of business and citizens’ dissatisfaction with regulation. This experience is often more negative than might be suggested by the measurable costs of administrative burdens."

3.1.4. The use of perception surveys to inform regulatory reform policy

36. As with other important government initiatives, monitoring and evaluation of regulatory reform programmes are integral factors in ensuring their long-term success. Governments need information on which programmes have been successful and on their strengths and weaknesses in order to guide both revisions and improvements to particular programs and the future evolution of regulatory policy as a whole. Ensuring public support for reform is also essential to the long-term viability of such programmes and perceptions of the regulatory environment and of the gains from reform therefore also constitute important feedback for governments.

37. A recently published OECD report identifies as an important innovation the increasingly widespread adoption of "perception surveys" in a number of OECD Member countries. The report's summary tables (pp 72-82) identify one or more such surveys in use in 14 Member countries. The tables discuss 21 surveys, with 13 first conducted from 2008 onward. The majority of these surveys are focused on the performance of administrative burden reduction programs, however, several take a broader view, seeking information on perceptions of the benefits of regulatory reform programs as a whole. For example, Korea has conducted a "Regulatory Reform Satisfaction Survey" annually since 2005, with the goal being "to measure the satisfaction level of the public and regulation experts and evaluate government agencies and implementation of regulatory reform".

38. Also of note is that, in Sweden, an industry lobby group instituted its own survey, with the twofold purpose of providing a picture of businesses” perception of the Government's better regulation programme and implemented simplification initiatives and pressing the Government to develop its own process to evaluate the results of the better regulation programme (p 81).

39. The report notes that perceptions of the regulatory environment and of reform progress are important in their own right - for example in influencing investment decisions - but that there are frequently significant differences between perceptions and objective measures of the reality. These "can be influenced by trust in government, the current economic situation, experience with front-line service, prior expectations and the content of government (and general media) communication.” This means that survey results must be interpreted carefully and governments should "look beyond" surveys, integrating the results with other measures of the regulatory environment and reform progress.

40. The broader context is one in which, as Coglanese (2012) has pointed out, governments' substantial investments in ex ante analysis of regulatory proposals stands in stark contrast to a general lack

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of investment in \textit{ex post} evaluation of regulatory impacts. Coglianese's paper seeks to provide governments with tools to address this problem by setting out a framework for undertaking regulatory evaluation at the level of individual regulatory programs. Analysis at this level appears to be particularly lacking: as Parker and Kirkpatrick (2012)\textsuperscript{13} point out, most analysis in this field appears to focus on attempting to identify the overall impact of regulatory management systems by constructing highly aggregated system quality indicators and analysing them on a cross-country basis in relation to aggregate measures of economic performance, using regression analysis. As the authors point out, "the reliance on regression analysis to investigate the relationship across countries between regulatory variables and economic outcomes has shifted attention away from the use of country specific case study evidence in the policy process."

3.2. \textbf{Innovation in relation to regulatory tools}

3.2.1. \textit{Innovation in relation to policy instruments}

41. A fundamental aspect of regulatory policy is to ensure regulators have a clear understanding of the full range of policy instruments available to government and their essential characteristics, so that sound, well-informed choices can be made systematically as to the appropriate policy instrument to address particular circumstances. Previous OECD research suggests that the use of particular tools - notably regulation - is often driven by habit and a tendency to "default" to a regulatory solution. In this context, innovation in respect of policy instruments embraces a number of related elements including refining existing tools, adopting existing tools to new circumstances and developing new tools.

- Innovation by refining the tool.

42. Traditional prescriptive forms of regulation have increasingly been displaced by performance based regulation and, more recently, by process based regulation. Such approaches are now widely used within most OECD countries. However, significant innovations in regulatory design can be identified beyond these distinctions between broad regulatory approaches. These seek to better tailor the regulatory tool to specific dynamics identified as existing within a particular regulated industry, or regulatory context. The "Chain of responsibility"

43. An important innovation developed in Australia during the past decade is known as the chain of responsibility. The regulatory problem which this seeks to address is that regulatory enforcement which targets only the person who commits the offence is likely to lack effectiveness in changing behaviour if it fails to recognise and address incentives within an industry that create strong pressure for non-compliant behaviour.

44. The concept was developed in the context of heavy vehicle transport, where strong competition among owner-operators seeking contracts from large freight forwarding companies has often led to contracts being agreed that can only be fulfilled by drivers adopting non-compliant behaviours such as extending driving hours beyond regulated maxima, widespread speeding and/or overloading.

45. The chain of responsibility concept recognises that "upstream" parties bear considerable responsibility for non-compliant behaviour in many such cases. Thus, it involves amended legislation that

allows penalties to be applied to freight forwarders or their officers, or other relevant parties, where they knowingly engage in behaviours that will encourage or require systematic regulatory breaches by others. This innovation seeks to improve regulatory effectiveness by targeting systemic, non-compliant behaviour at its source and addressing the underlying behavioural dynamics.

46. The following provides information on the operation of this concept in Victoria, Australia: http://www.vicroads.vic.gov.au/Home/Moreinfoandservices/HeavyVehicles/ComplianceAndAccreditation/ChainOfResponsibility.htm

- Innovation by adopting new tools.

47. The previous sections have discussed innovations arising from improved understanding of the characteristics of various policy tools, including regulation, and their adopting in new, or non-traditional contexts. However, another, more fundamental, source of innovation in terms of policy tools is that of the development of entirely new tools. A key area of innovation in recent years has been that of attempts to apply the insights of behavioural economics within the regulatory/public policy space. Behavioural economics is based on the application of insights form psychology to economic issues. The key benefits sought are a better understanding of people's motivations and behaviour in markets which, in turn, have obvious implications for policy and regulatory approaches, particularly in relation to consumer policy and regulation.

*The "nudge"

48. A highly influential public policy concept based on the application of behavioural economics is the "nudge theory", which is set out in detail in a 2008 book by Thaler and Sunstein. Nudge theory is based on conclusions from research in behavioural economics and psychology which suggest that, in many circumstances, most people do not act in ways consistent with the traditional economic view of man as a maximiser of his long-term economic welfare, as a result of a number of psychological and neurological biases, including the tendency to use heuristics and the impact of common fallacies. The theory suggests that an appropriate set of interventions in response to this observation would encourage making of choices with better long-term outcomes and discourage choices with poor long-term results. However, a key element of the nudge approach is to leave people free to make "poor" choices. This approach of encouraging "good" choices without preventing "poor" choices is described as one of "libertarian paternalism".

49. Examples of interventions recommended via the application of the nudge theory include:

- Addressing systematic financial under-provision for their retirement by individuals by allocating people who fail to make a conscious choice in relation to retirement savings plans to a default plan that would ensure that a moderate level of saving occurs;

- Providing information on the compliance behaviour of other parties to non-compliant individuals in order to encourage compliance. For example, informing people who have not paid their taxes that the majority of people in their area have paid has been shown to substantially increase payment rates.

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• Increasing organ donation rates by requiring people to make a conscious election as to whether to be a donor or not - for example as part of the driver licence renewal process.

50. A small number of OECD Member country governments, including Denmark, France, Britain and Australia have begun working on applying nudge concepts in their policy implementation. For example, the British Government established the Behavioural Insights Team (BIT) within the Cabinet Office in mid-2010 "to find innovative ways of encouraging, enabling and supporting people to make better choices for themselves" - a commitment that formed part of the coalition agreement of the newly elected government. The approach taken combined efforts to:

• implement nudge-based reforms in specific policy areas; and

• spread understanding of behavioural insights across government.

51. An additional innovation developed by the BIT is the use of "Randomised Controlled Trials" to test public policy interventions. This involves the use of a randomly assigned control group to enable testing of a "base case" - i.e. what would have occurred in the absence of the specific policy intervention being tested.

52. The ‘Danish Nudging Network’ (DNN) represents a slightly different approach to attempts to adopt the nudge theory. Created in December 2010 it is not specifically government based but, rather, aims to increase interest in the nudge theory and create a network of stakeholders, including researchers, policy-makers and others interested in exploring the potential of, and problems with, the use of behavioural theory in both public and private institutional contexts.

53. The adoption of the nudge concept represents an example of innovation providing scope for "lighter handed" interventions that are likely to be both more effective and less costly to implement than traditional regulatory approaches. Importantly, it also retains greater scope for individual choice and autonomy than the "command and control" approaches that might traditionally have been adopted.

3.2.2. Regulatory Impact Analysis

54. Regulatory impact analysis is a well-established tool for improving regulatory quality and ensuring that the regulatory tool is used only where it is likely to be welfare-enhancing. RIA has a history spanning over 25 years in a small number of countries and spread rapidly through the OECD Member countries during the mid and late 1990s. While RIA is now used in almost all OECD Member countries, there continue to be substantial new developments and innovations in relation to its use. Most obviously, many countries have progressively expanded the scope of RIA: in some cases it has initially been applied to primary laws and has later been expanded to include lower-level rules, while in others the converse has occurred. Some countries, such as Mexico, which have a long history of using RIA at national level have recently moved to encourage its adoption by sub-national governments.

55. Specific innovations in relation to RIA largely relate to two broad areas: methodology and process.

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16 http://www.cabinetoffice.gov.uk/behavioural-insights-team
18 See: http://www.inudgeyou.com/danish-nudging-network/
Methodological improvements

56. The OECD's 2009 publication *Regulatory Impact Analysis: A Tool for Policy Coherence* includes a substantial discussion of key methodological issues in RIA, with a focus on identifying both key areas of weakness and promising innovations or insights potentially able to address these weaknesses. In particular:

57. **Risk assessment.** RIA guidance has historically emphasised the importance of developing sound objective measures of the risks being addressed by policy, both to enable assessment of the case for action and to assess the merits of different options. However, little account has been taken of more subjective issues of public perceptions of the importance of different risks and their acceptability. Conversely, there is a large risk literature which argues that taking account of such "subjective" factors is essential to good policy analysis. A key area for future innovation in RIA practice seems to be to achieve a sound synthesis between the objective and subjective approaches to risk or, alternatively put, to pay heed to the notion of the varying degree of "acceptability" of different types of risk. To do so would, at least arguably, be more consistent with the utilitarian framework of analysis which economics applies. It would also provide a better basis for RIA to take account of the broader policy environment within which its insights must be used. Moreover, by producing results that are more reflective of populations' actual perceptions of risk, such approaches inevitably enhance the expected degree of influence of RIA on policy/regulatory outcomes.

58. **Discounting.** Research shows that OECD Member countries adopt a wide range of different discount rates for RIA purposes. While such differences can be legitimate reflections of underlying differences in social preferences, it appears that the practical reality is that different conceptual approaches also underlie the recommended rates in different countries, with some rates being set on the basis of the social rate of time preference and others on the basis of the opportunity cost of capital. Ensuring that discount rates reflect a clearly considered social view on this issue, as well as setting a standard, or default rate to encourage a coherent RIA approach across different policy areas would constitute important steps forward in this area.

59. In addition, the setting of discount rates should take account of recent controversies over whether differential (in practice, declining) discount rates should be adopted in respect of very long-term initiatives. The OECD concluded in 2009 that there were unresolved conceptual issues in this regard and that governments should therefore exercise caution in this area. However, ensuring that guidance on discounting is cognisant of this controversy is clearly a step forward in terms of RIA methodology.

60. **Multi-criteria analysis.** While benefit-cost analysis (BCA) is widely accepted as the "gold standard" in terms of RIA methodologies, it is also widely understood that data limitations will, in many cases, mean that a fully quantified BCA cannot be completed. The OECD has highlighted the importance of achieving a sophisticated integration of quantitative and qualitative analysis in these circumstances, with this element of the RIA being fundamental to its overall quality. However, the question of how to ensure a systematic and objective approach to qualitative analysis remains open. In recent years, a small number of RIA guidance documents have highlighted the potential value of Multi-Criteria Analysis (MCA) in this regard. MCA is a process of identifying and weighting specific assessment criteria and scoring feasible alternative regulatory/policy interventions against each criterion. It ensures that a high level of transparency is achieved in relation to the qualitative aspects of RIA, thus facilitating dialogue among stakeholders and the ability to challenge the conclusions reached. It also helps to ensure that all relevant factors are identified and considered explicitly.

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19 See: http://www.oecd.org/gov/regulatorypolicy/regulatoryimpactanalysistoolforpolicycoherence.htm
61. A key source of experience with MCA in the RIA context is that of the State of Victoria, Australia, where all RIA that do not include a fully quantified BCA have been required to use MCA for several years. An online archive of RIA documents provides a substantial number of examples of the use of MCA in the regulatory context, while a detailed RIA guidance document is also available, which includes a discussion of the application of MCA in the regulatory context^{20}. MCA has also been used by the United Kingdom Government for over a decade. A detailed manual prepared for the UK Department of the Environment, Transport and the Regions by the London School of Economics notes that^{21}:

"...MCA is not a substitute for cost-benefit analysis, but it may be a complement; and that MCA techniques are diverse in both the kinds of problem that they address (for example prioritisation of programmes as well as single option selection) and in the techniques that they employ, ranging from decision conferencing to less resource intensive processes."

62. This manual provides substantial detail on the practice of MCA, as applied to the public policy context, including detailed methodological guidance and case studies.

Process improvements

63. While good methodological approaches are essential to achieving sound RIA outcomes, they must be applied in the context of a sound procedural framework. The OECD has highlighted key issues including: the need to ensure that regulators are responsible for the conduct of RIA, but are subject to independent quality assurance processes, managed by regulatory reform authorities; the need to ensure that RIA is integrated with effective public consultation processes and the need to ensure that RIA is commenced at an early stage of the policy process in order to ensure its potential to be influential in policy decision-making.

64. Consistent with these essential process elements, two innovations adopted in Mexico in recent years appear to have the potential to add significant value. These are, the practice of "real time" publication of draft RIA and responses from both stakeholders and the regulatory reform authority and the use of external independent experts.

65. **Real time publication.** Current practice by Mexico's regulatory reform authority, Cofemer, is to immediately publish on its website a wide range of RIA-related documentation, including draft RIA, Cofemer's assessments of these drafts and consultation comments from stakeholders and the general public. This ensures a high level of transparency and facilitates more informed consultation and debate. In addition, it may provide useful incentives for regulators to provide high quality RIA from the outset, through the knowledge that draft documents will be made public and subject to scrutiny and comment.

66. **Use of independent experts.** Mexico's RIA processes, perhaps uniquely among OECD Member countries, provides for an effective "circuit breaker" in circumstances of conflict between the regulatory authorities responsible for drafting a RIA and the regulatory reform authority responsible for quality assurance (Cofemer). Where a regulator's response substantially fails to address the concerns with the draft RIA raised by Cofemer, and the RIA relates to a high impact regulatory proposal, Cofemer may request the appointment of an independent expert, at the agency's expense.

67. The expert will, at a minimum, review the aspects of the RIA that Cofemer has highlighted as inadequate. The regulatory agency can choose the expert from an approved list prepared by Cofemer.


^{21} See: http://eprints.lse.ac.uk/12761/1/Multi-criteria_Analysis.pdf
Alternatively, the regulatory agency may propose an expert for appointment, in which case Cofemer has a right of approval. Cofemer provides the terms of reference for the expert review. The expert's report is due within forty working days of their appointment and their conclusions must be taken into account in the further development of the RIA. Cofemer notes that, while this tool is used infrequently in practice, it appears to be influential in encouraging regulators to respond positively to Cofemer's inputs.

**RIA quality control**

68. OECD best practice principles in respect of RIA have long argued for the importance of an independent oversight body having a quality control function in respect of RIA. Most OECD Member countries have adopted this element as part of their RIA systems, though very different approaches have been taken. In recent times, Raedelli et al (2010) has argued, in the particular context of RIA systems, that appropriate mechanisms of formal authority may be necessary, but are not sufficient, to a good outcome. Rather, establishing actual authority, based on the response of key political players to the role of the oversight body is crucial:

"The key is NOT about writing laws and decrees about the "power" of different actors. It is about making certification emerge from the system of interaction around RIA. The lesson of the Secretariat General of the Commission is arguably the most eloquent in recent years, but the Office for Management and Budget in the USA has a long track record of actor’s certification, extremely robust since it has been "certified" by different administrations with very different regulatory priorities.

**Impact of innovation**

69. RIA is, fundamentally, a tool to enhance the quality of regulation, both by encouraging better regulation and by discouraging poor quality regulation as a response to policy issues. Innovations in terms of RIA methodology have the potential to enhance its effectiveness in assessing likely regulatory effectiveness and efficiency. RIA process innovations, on the other hand, are likely to have indirect effects in improving RIA quality and, hence, regulatory quality. Process innovations can help to enhance the level of stakeholder participation in RIA, a factor that it likely, in turn, to improve analytical quality by both bringing forward more data and better testing regulators' understanding of the regulatory context. In addition, greater stakeholder participation in RIA is likely to make RIA more influential in determining the final regulatory outcome, as it will tend to raise the political cost of making decisions contrary to the conclusions of the process if that process embraces greater community and stakeholder involvement and the increased legitimacy that this confers.

3.2.3. Consultation

70. While many, or even most, OECD countries have long histories of adopting stakeholder consultation as an integral part of regulatory development, there has been much change over time in the way this tool has been used. As a general observation, consultation processes have become:

- more open, with greater public involvement and a comparatively lesser emphasis on a highly structured interaction between organisations representing "the social partners" or broader interest groups; and

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22 Detail on this process is available in the Mexican Government's RIA manual, the *Manual de La Manifestación de Impacto Regulatorio*, (Diario Oficial, 26 July 2010). Available at www.cofember.gob.mx.

• more formally structured, with specific process requirements for the conduct of consultation increasingly being spelled out, either legislatively or administratively.

71. The ability to conduct widespread and effective consultation has clearly been enhanced substantially by technological change. Increasingly, it has become generally expected that a wide range of materials including, regulatory proposals, discussion papers and stakeholder comments will be internet published and generally available. Electronic communications have improved the timelines of consultation initiatives, enhancing stakeholders' ability to engage and be influential. Electronic access to a range of archival material - such as past RIA documents - can also enhance the effectiveness of consultation. The Mexican approach to publishing a wide range of RIA-related materials as part of an inter-active consultation, discussed above, represents a significant example of the use of these opportunities.

3.2.4. Risk assessment

72. Risk assessment tools can be used at several stages of the regulatory cycle, in order to contribute to better quality regulatory outcomes. At the problem definition stage, risk assessment is crucial to determining whether the "threshold test" is met - that is, whether the problem identified is of sufficient magnitude as to merit government intervention. As discussed above, more detailed risk assessment also forms an important part of the process of regulatory design and development, particularly in the RIA context. In addition, significant innovations have been made in recent years in the use of risk assessment as part of regulatory implementation and enforcement.

73. A substantial reform program in this area was commenced by the United Kingdom Government in the mid-2000s. The "Hampton Report"\textsuperscript{24}, published in 2005, argued that risk assessment should drive all inspection and enforcement activity, so that the burden of enforcement falls most heavily on those businesses with the highest risk and least heavily on those with the best compliance records. Importantly, given that much of the initial focus of the project was on administrative burden reduction, Hampton believed that inspection activity in the UK could be reduced by around one third without compromising regulatory performance (BIS 2009).

74. Hampton reported that most regulators recognise the merits of a risk-based approach to regulatory administration and enforcement. Consequently, he saw a large part of the reform task as being to support regulators to implement best practice approaches - e.g. by publishing background materials and guidelines that complement the risk policy - and assist in developing a supporting ‘community of practice’. Importantly, Hampton also highlighted the need for a dialogue with the public on risk issues. In an approach with relevance to the objective/subjective risk dichotomy discussed above, Hampton argued for a focus on enhancing public understanding of risk and of the roles of individuals and the government, while also seeking to provide government with a clearer view of public attitudes and areas of concern in relation to risk.

75. Implementing this approach in the UK involved a detailed process of benchmarking regulators' practices against a risk management policy to identify priorities and strategies for reform. It also required follow up and reporting to ensure reform occurred and to address any remaining issues. Details, including copies of these reports are available on the website of the UK Department of Business, Innovation and Skills\textsuperscript{25}.


\textsuperscript{25}See: http://www.bis.gov.uk/policies/bre/enforcement-of-regulation/Hampton-Reviews/hampton-implementation-review-reports
76. It can also be noted that the Hampton approach shares many conceptual similarities with the approach to regulatory compliance issues adopted for many years in the Netherlands, and summarised in the "Table of 11" compliance determinants. This table is a tool which enables regulators to assess the risks of non-compliance in specific regulatory circumstances, having regard to the characteristics of both the regulated group and the regulatory structure which they face. It highlights three broad sets of issues: the determinants of voluntary compliance, the factors influencing the probability of detection and the impact of expectations regarding sanctions.

3.2.5. Sanctions and enforcement

77. A tool that is closely related - indeed, arguably indivisible - from compliance strategies is that of sanctions for non-compliance. As suggested above, the Dutch "Table of Eleven" compliance determinants highlights both the likelihood of sanctions being applied and their nature and severity as being key factors in determining the level of compliance.

78. A broader perspective sees the appropriateness of the sanctions available to be applied as an important factor in determining compliance in the dynamic context. One issue increasingly acknowledged is that regulators are frequently reliant on a relatively narrow range of sanctions and can often face circumstances in which none of the available sanctions is appropriate to a particular instance of non-compliance. For example, a regulator in an industry in which government licensing is required in order to operate may face situations in which their only realistic sanction is to withdraw licensing. Such a sanction is clearly inappropriate in all but the most serious cases of non-compliance. However, the failure to apply a sanction where lesser cases of non-compliance are detected will have negative implications for future compliance performance.

79. Recognition of these issues in recent years has seen a focus on the development of a range of innovative sanctions that are designed to respond appropriately to different kinds of non-compliance in different regulatory circumstances. Reflecting the close linkage between compliance and enforcement noted above, one outcome of the Hampton review in the United Kingdom was the commissioning of the "Macrory Report" in 2006. The Macrory review sought to achieve greater consistency in the use of sanctions between regulators and, crucially, to ensure that the available sanctions were consistent with the risk based approach to regulation recommended by Hampton.

80. A particular focus was on ensuring that all regulators had access to a range of administrative penalties (accompanied by appropriate appeals mechanisms), rather than being entirely reliant on criminal mechanisms. An incentives based approach was also identified as necessary, including the ability to deprive regulated entities of the full economic benefit of their non-compliance, at least in cases of long-term non-compliant activity. However, access to this enlarged "toolkit" of sanctions was to be predicated on regulators being compliant with relevant principles of good regulatory implementation practice.

81. The Legislative and Regulatory Reform Act of 2006 enshrined the principles of good regulation developed by the Better Regulation Taskforce – consistency, proportionality, accountability, targeted and transparent - in law and required all regulators to ensure that they operate in accordance with the principles.

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The Act provided a power to create the statutory Regulators Compliance Code. The Code is structured around the Hampton Principles and provides a framework that applicable regulators must have regard to when developing policies and procedures. The Code came into force in April 2008 and aimed to change regulatory culture. It followed the failure of the earlier, voluntary Enforcement Concordat, to achieve this goal. The Code also had significant focus on reducing burdens from inspections, including by encouraging joint inspections, multi-agency working and improving data sharing.

82. The Macrory recommendations on sanctions were largely implemented via the Regulatory Enforcement and Sanctions Act 2008\(^{29}\). Part 3 of the Act provides to regulators wider range of civil sanctions that are intended to be more proportionate and flexible responses to cases of regulatory non-compliance. These include *fixed monetary penalties*; *discretionary requirements* (such as variable monetary penalties and non-monetary requirements), *stop notices*, and *enforcement undertakings*. In particular, the extended toolkit allows regulators to remove the financial benefit gained by businesses that deliberately seek an advantage though non-compliance with their regulatory obligations, while helping to secure increased compliance.

83. Similar approaches have also been adopted in a number of regulated sectors in Australia. For example, the 2011 National Heavy Vehicle law includes a wide range of both administrative and criminal sanctions to enable the heavy vehicle regulator to respond appropriately to non-compliance in many different circumstances. These sanctions include: formal warnings, infringement notices, fines, commercial benefits penalty orders, suspension or cancellation of registration, supervisory intervention orders, prohibition orders and compensation orders. The law also applies the “chain of responsibility” concept, discussed above, in order to ensure that these penalties are applied to the appropriate party, having regard to the initiating factors of the non-compliance\(^{30}\).

### Benefits of innovation

84. The adoption of innovations such as those highlighted above focuses on improving regulatory effectiveness and efficiency. Regulatory effectiveness is enhanced to the extent that compliance with regulatory standards can be increased. While the Table of Eleven notes the importance of the "voluntary compliance" dynamic, it also makes clear that increasing the probability of detection, through innovations that make better use of limited regulatory resources, such as better directed, risk based auditing and inspection activity, will encourage improved compliance over time. Similarly, the ability to apply proportionate sanctions and to choose the most appropriate from a suite of sanctions options can provide better incentives and, again, encourage higher levels of compliance over time.

85. Important regulatory efficiency gains can also be derived through this process. As noted above, Hampton identified the potential for significant resource savings through better directed compliance and enforcement activity - savings that do appear to have been achieved in practice. That said, subsequent research showed that the decline in inspection activity post-Hampton was in many cases much larger than anticipated and raises the question of whether regulatory effectiveness was in danger of being

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compromised as a result. This raises the issue of the need to avoid seeing the purpose of innovation as being predominantly or largely in terms of the opportunity to reduce regulatory cost.

3.3. Innovation in relation to regulatory institutions

86. The importance of the institutions of regulatory governance has been widely accepted for many years. Loayza et al. (2004) have provided empirical support for the importance of institutions. While their work shows that increasing regulation generally reduces economic growth rates, they also find that the size of this impact declines as institutional quality improves and that, ultimately "if the quality of governance is sufficiently high, an increase in [the overall index of] regulation can have a positive impact on growth".

87. Key institutional factors in the regulatory policy context include:

- Ministerial accountability for the delivery of regulatory policy outcomes, consistent with OECD best practice principles that highlight the key role of high-level political support in ensuring the success of regulatory policy initiatives;
- Regulatory oversight bodies with the authority and the resources needed to promote, support and monitor regulatory policy initiatives; and
- Independent regulatory agencies, able to deliver high-quality regulatory administration free from political interference and special interest pressures.

88. The following highlights important trends and innovations in each of these areas.

3.3.1. Ministerial accountability

89. While it is widely accepted that successful regulatory policy requires high level political support, a number of different models have emerged over time for allocating responsibility and, in effect, providing this support. Thus, in some countries, individual Ministers are given portfolio responsibility for the performance of the regulatory policy, while in others this is a collegiate responsibility undertaken by each Cabinet Minister and, in still other cases (e.g. Korea) Cabinet committees have been established, meaning that responsibility for regulatory policy is shared by a specific sub-group of Ministers. There appears to be no clear view, at present, as to whether one model is likely to perform better than others.

90. However, a factor that is perhaps more significant than the allocation of a generic responsibility for regulatory policy is the question of whether specific accountabilities are created. As an example, Jacobs (2006) has noted a relatively recent tendency for Ministers or high-level civil servants to be made personally accountable for RIA quality within their departments. Jacobs identifies this innovation as being associated with Westminster parliamentary systems and cites Canada, New Zealand and the United Kingdom as examples, while the State of Victoria (Australia) constitutes another in which the Minister's

responsibility to personally endorse the quality of the RIA document is set out in legislation. Jacobs argues that:

"This approach has generally worked in the sense that ministers are aware of the RIA and the quality issues around RIA take a higher profile. In some countries, however, this is become little more than a paperwork exercise, and ministers seem to be generally unaware of the content and quality of the RIA."

3.3.2. Regulatory oversight bodies.

91. Virtually all OECD countries that have adopted regulatory reform policies have established regulatory oversight bodies to drive the implementation of the policy. The responsibilities of these bodies have tended to broaden over time, toward a converging set, embracing most or all of:

- Co-ordination and supervision of the reform agenda;
- Provision of advice, training and technical assistance to regulators;
- Quality assurance in respect of regulatory impact analysis;
- Advocacy of new or improved reform policies/initiatives;
- Challenging regulatory reform proposals.

92. There has also been a clear trend in the location of these bodies, with many moving from locations in the industry department, the justice ministry or other locations into the centre of government - typically the president or chief minister's office, although sometimes the finance ministry. These moves have reflected recognition of at least two factors crucial to their effectiveness. First, reform bodies must have a high level of political authority to succeed in their task. Second, the reform agenda must be understood as being based on maximising social welfare, rather than as an arm of industry policy, or indeed any other form of sectoral policy. A whole of government perspective is also critical.

93. Particularly in countries with relatively mature regulatory policy systems, these oversight bodies are increasingly taking on the role of catalysts of regulatory innovation. In some cases, this results from them researching and disseminating information on promising developments in regulatory practice. In other cases, they are developing their own regulatory innovations, or taking leading roles in implementing such innovations in practice.

94. One innovation in relation to regulatory oversight bodies adopted in a few OECD countries in recent years reflects the increasing focus on ensuring that the regulatory reform agenda is applied consistently across levels of government. This focus has meant that national governments have increasingly sought to convince sub-national governments of the benefits of adopting a reform agenda and have often provided resources and expertise to "seed" its establishment and try to ensure its consistency with the national approach.

95. At the institutional level, one aspect of this has been that the national regulatory reform bodies have broadened their remit to include the provision of these services to regional or local governments. In

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some cases, this has also led to encouragement of the establishment of local level regulatory reform authorities.

96. For example, in Mexico, COFEMER has worked systematically to propagate a regulatory quality agenda at both State and local government levels and currently devotes a significant amount of staff resources to this task. A recent innovation has been to encourage sub-national governments to adopt their own, explicit regulatory policies as a means of promoting regulatory quality systematically. This necessarily includes strong promotion of the use of RIA at state level and embraces the development of an adapted RIA model that can be applied in this context. Partly as a result of these Federal initiatives, around two thirds of States have now adopted regulatory improvement laws, with their own regulatory reform authorities being established to drive the implementation of these requirements in most cases.\(^{35}\)

97. This outreach program also supports the adoption of regulatory policies at lower levels of government through the provision of training to officials from all levels of government. A further innovation by COFEMER in this respect is that it has substantially enhanced the scope and quality of training provided. Rather than simply providing technical training to assist officials in completing RIA, it now offers a formalised, high-level training course known as the Diploma of Regulation. According to the OECD review of regulatory reform in Mexico:

"This is intended to provide regulatory agency officials with the tools to conduct economic analysis of regulatory issues, to assist them in developing regulatory proposals that are consistent with concepts of economic efficiency and to ensure an understanding of the RIA guidelines."

98. To this end, the course includes four modules covering introductory material, economic and financial regulation, social regulation and RIA. It requires a considerable commitment of at least 60 hours of direct study, plus private study. However, despite this it has proven immediately popular, with over 6,500 officials registering to participate since its inception in early 2012 and students being drawn from the private sector, as well as from various levels of government. Importantly, the course is international in its orientation, having been developed in collaboration with the Latin American Network of Regulatory Improvement and Competitiveness (LATIN_REG).\(^{36}\) This attempt to provide a more extensive engagement with the broader regulatory policy agenda, rather than the more "mechanistic" RIA courses that have historically been delivered by regulatory oversight agencies, appears to be highly promising in terms of its ability to engage a wide range of officials, albeit that its recent implementation means that limited evaluation is possible at present.

99. Another OECD Member country that has sought to provide the services of a regulatory oversight body at sub-national level is the United Kingdom. Responding to the Hampton Report's observation that most interactions between regulators occur at the local level and that there is consequently the potential for local regulation to be a major source of business concerns regarding regulatory implementation, a Local Better Regulation Office was established in 2008. The role of the LBRO is set out in legislation.\(^{37}\) Its objective, however, is to act as an arms length body responsible for improving the delivery of local authority regulatory services.

100. A key LBRO statutory responsibility is to establish and manage the Primary Authority scheme.\(^{38}\) This scheme was originally introduced to address inconsistency of advice and enforcement between local

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35 OECD (2012). Regulatory Reform in Mexico.
36 For more detail, see: http://www.cofemer.gob.mx/Diplomados/Diplomados.aspx
37 See the Regulatory Enforcement and Sanctions Act 2008. UK Government.
38 For information on LBRO and its impact, see
authorities and is focused on the development of relationships of trust between regulators and business. It enables a business to receive tailored advice that is agreed once and respected by the rest of the regulatory system. Through inspection plans, businesses and regulators can focus on the highest risks and reduce duplication of effort through greater recognition of businesses own systems of compliance. The Enterprise and Regulatory Reform Bill, currently before the UK Parliament, proposes to extend Primary Authority to enable more businesses, including franchises and trade associations, to receive the benefits of the scheme.  

3.3.3. Independent regulators

101. There has been a relatively gradual, but sustained movement toward use of independent regulatory agencies in a wide range contexts since at least the late 1990s. Responses from a group of OECD Member countries conducted as part of the Value for Money Project indicate that independent regulators are likely to be established where a high value is placed on ensuring the credibility of the regulatory structure by demonstrating its independence from political interference and its transparency, thus providing a guarantee of consistent regulatory decisions serving clearly articulated (usually in legislation) regulatory goals and priorities. There also appears to be a clear preference for the use of independent or arms length agencies in the context of regulatory tasks requiring high levels of specific, technical skills.

102. During this process, there has been widespread use of both "sector-specific" regulators, responsible for only a single industry or regulatory environment, and multi-sectoral agencies, with little clear trend in terms of the use of one or the other model. More recently, however, research has suggested a clear trend toward the use of a multi-sectoral model. Jordana and Levi-Faur (2010) find, as the result of an extensive quantitative analysis, that:

"...the scope of agencies has been expanding fast since the late 1990s, often as a result of the extension of regulatory agencification to new sectors, and second, that multi-sectoral agencies are more common in Europe than in Latin America, in economic regulation than in social regulation, and in smaller countries than in bigger ones."

103. The authors have found that, within Europe, significantly larger proportion of regulatory sectors is now regulated by multi-sectoral agencies than sector-specific agencies, in clear contrast to the late 1990s position.

104. Jordana and Levi-Faur point out that the theoretical literature does not reach a clear conclusion as to whether independent regulators should be organised on a sector-specific or a multi-sectoral basis. The major benefits of sector-specific agencies highlighted by their proponents include superior ability to develop a critical mass of sector-specific regulatory expertise, reduced risk of the agency becoming unduly influential within the policy space and their ability to facilitate regulatory experimentation, by allowing different regulatory approaches to be adopted in different sectors. Supporters of multi-sectoral agencies,
by contrast, highlight the benefits of regulatory consistency, particularly where there is technological convergence or product bundling, economies of scale and scope in regulation and reduced risk of regulatory capture.

105. In this context, the long-term trend identified is of strong interest, as it suggests that governments are increasingly reaching a consensus in favour of multi-sectoral agencies, based on their practical experience with the implementation of these options. Of note is that the authors conclude that agencies rarely broaden their scope of operation through merger but, rather, tend to grow organically, with established agencies being given progressively wider fields of operation.

4. The potential for regulated entities to drive regulatory innovation.

106. The above discussion of the "burden hunters" program adopted in Denmark provides one example of a process which relies, at least to some extent, on regulated entities to act as active participants in the process of identifying potential regulatory innovations. However, as a general observation, there appear to have been limited steps taken by governments in this direction. While broad-ranging inquiries into regulatory reform issues generally seek input from stakeholders and are often the subject of considerable interest, more targeted attempts to harness regulated entities' detailed knowledge of the regulatory environment and the main problems it causes for their businesses in order to identify potential improvements appear to be rare.

107. The Canadian Regulatory Efficiency Bill of 1994 remains a rare attempt to formulate a regulatory architecture that would allow for such "bottom up" reform efforts to be accommodated systematically within the regulatory structure. The Bill would have allowed Ministers to approve alternative methods of compliance with regulations by delegating to them the power to make a “compliance order” which would set out the alternative compliance conditions for a particular business or industry. This would effectively mean that regulated entity could, at least theoretically, design an alternative set of compliance requirements to achieve the objectives of a set of regulations, thus allowing regulated groups a strong influence on regulatory design.

108. A Comprehensive Regulatory Reform Bill introduced to the US Congress around the same time contained similar provisions. However, neither Bill was ultimately enacted. A later inquiry by a Parliamentary Committee in Victoria, Australia, recommended the adoption of a similar approach but was, likewise, unsuccessful in achieving such reform. No similar initiatives appear to have been adopted, or proposed in recent years, perhaps due to the strong criticisms of this approach made by some civil society groups, who saw it as being likely to substantially undermine regulatory protections.

109. However, there has recently been increasing interest in the concept of "private sector" or "market based" regulation and the potential implications for government of the rapidly increasing activity in this area. Examples of this dynamic include:

- Action by major retailers (e.g. supermarket chains) or distributors to require that their suppliers meet certain standards in respect of environmental performance (e.g. sustainably harvested tuna, palm oil free products), social goals (e.g. "fair trade" or "cruelty free" production of eggs, pork or other animal products) or product standards that exceed regulatory minima;

- Organised consumer boycott campaigns mounted by various NGOs that aim to press manufacturers and/or distributors to change their production processes in ways that serve objectives such as those noted above;
• Less formal consumer action (e.g. either "viral" campaigns arising from new media or essentially individually based action) which may similarly affect aspects of the production and distribution process, rather than expressing preferences for a narrow range of product attributes, as per traditional demand models.

110. The apparently rapid increase in activity in these areas suggest that governments should consider the implications of these trends for their own regulatory activities. Some key questions for consideration in this context would potentially include:

• Whether efforts to harness or direct these forms of action could constitute an alternative, or a complement, to traditional regulation in certain circumstances;
• In the limiting case, whether there are circumstances in which private "quasi-regulatory" activities would obviate the need for government regulation altogether;
• If so, how to recognise these circumstances;
• Whether the above trends have possible negative implications for economic welfare, or for social values;
• If so, what factors might give rise to these negative impacts and how might they be addressed;
• Whether there are historical precedents for the activities identified above and what research is available in relation to these cases.

111. While there appears to have been little formal action by OECD Member governments to address the implications of this issue, an emerging literature addresses many of the above questions and provides guidance to governments seeking to engage in this area in the future\(^42\). The likely continuation in the growth in importance of these forms of private regulation suggests that regulatory policy agendas will increasingly need to address the implications for government regulatory activity, in order to avoid such developments undermining the better regulation agenda and, indeed, in order to harness opportunities to leverage this activity in support of regulatory policy.

5. Using “regulation inside government” as a tool to promote innovation in the public sector.

112. While regulatory dynamics are most commonly considered in terms of government acting to regulate the private sector, government also applies a range of regulatory requirements within the administration itself. These requirements have the potential to increase significantly the costs of government administration and are, at least arguably, subject to similar dynamics in many respects to those

\(^{42}\) See, for example:


governing regulation as traditionally conceived. This suggests that reform of this "internal regulation" may yield significant benefits within the broader context of regulatory innovation.

113. A significant project of this type was undertaken by the Australian government, commencing in 2007\textsuperscript{43}. It was commenced in response to a 2005 report which identified two major concerns in this area:

- That the processes by which internal regulation is developed and implemented have not been sufficiently rigorous, consistent or systematic; and
- That internal regulatory requirements are often poorly understood by agency staff and that risk aversion often leads them to adopt unduly onerous processes that are not actually required by the internal regulation in place.

114. The reform project embraced two distinct elements, to respond to the two separate problems identified above. The first of these was the development of an explicit framework for designing, and subsequent review of, intra-governmental regulatory and administrative processes. The framework largely mirrored the requirements of a high quality regulatory process, as advocated by the OECD and largely implemented by Australia in the context of its broader regulatory role. Thus, standard were set in respect of:

- Design and analysis;
- Stakeholder consultation;
- Independent advice; and
- Decision-making.

115. The design and analysis stage requires RIA type disciplines to be adopted, including explicit problem definition, identification of feasible options and the use of benefit/cost analysis to assess them in comparative terms. In addition, a requirement was introduced for all regulation internal to an agency to be reviewed at 3 - 5 yearly intervals, while all "whole of government" internal regulation is to be reviewed at 5 - 10 year intervals. These requirements were set out and explained in detail in the publication \textit{Reducing Red Tape in the Australian Public Service}\textsuperscript{44}.

116. The second initiative was a program aimed at improving understanding of actual internal regulatory requirements, particularly through identifying and correcting common “myths” regarding these requirements. This initiative arose after initial research showed that there were widespread misunderstandings among government officials as to the nature of the administrative requirements with which they were required to comply, in a wide range of areas.

\textsuperscript{43} For a detailed description and analysis of this initiative, see OECD (2008) \textit{Budgeting in Australia}. Available at: http://www.oecd.org/gov/budgetingandpublicexpenditures/42007191.pdf

117. The key initiative in this regard was the publication of by the Department of Finance and Administration of a book identifying key "myths", or widely held misunderstandings, regarding internal regulation and clarifying the requirements that are actually in force\textsuperscript{45}.

Value for money program

118. The OECD's Value for Money Inside Government program commenced in late 2009 and has resulted in the publication of a number of country reviews. Its final synthesis report is expected to be published in early 2013. The program takes a broad view of innovation in government administration, including issues such as shared services, ICT/e-government, financial management, internal audit and policy evaluation, automatic productivity cuts and the quality of the civil services. Most or all of these topics are of relevance for the broader OECD observatory program. However, one specific stream of this work is of direct relevance to the issue of regulatory innovation. The "Regulation and Supervision" stream embraces three areas:

- the use of independent regulatory agencies;
- risk based supervision; and
- the maximisation of the use of general and cross-sectoral economic regulators.

119. The first of these issues is discussed in the country reviews already published in respect of the Netherlands and Australia\textsuperscript{46}, while the second and third will be discussed in the reviews covering the European Union and the United Kingdom, respectively. A synthesis discussion will also be published as part of the final report. The content of this material is expected to be broadly consistent with that contained in the equivalent discussions in Section 3, above, but is likely to contain more detail on current country initiatives and the "state of play".

6. Conclusions

120. The regulatory policy agenda is inherently one that relies on innovation as a key driving force. Its underlying purpose is to maximise the economic welfare benefits arising from the use of regulation by governments. This means working systematically to improve both the effectiveness and efficiency of regulation - including by identifying where alternatives to regulation are preferred and where no government intervention is justified. The work of the OECD over the past 20 years and more has document, and contributed to, substantial improvements in understanding of the characteristics of regulation as a policy tool and of the dynamics of regulatory systems. This has led to a rapid increase in innovation in this field, which continues to the present.

121. The above discussion has shown how innovation at various stages of the regulatory cycle can contribute to the achievement of these goals and how innovation can be applied throughout the regulatory policy framework of policies, tools and institutions. In some cases, such as the Standard Cost Model Network, innovations have spread rapidly across the OECD Membership and beyond. However, in a number of other cases, innovations have been identified that, while apparently promising, have seen little take-up beyond their country of origin, in some cases despite significant time elapsing. One explanation for these observations may be differences in economic, social and institutional contexts: some innovations


may be more readily accepted in some country contexts than others. However, it also seems likely that there has been too little effort made to disseminate details of innovative practice across the OECD Member countries.

122. In this context, the OECD Observatory provides an important "clearing house" for the dissemination of information about innovations within the regulatory policy space. It has the potential to leverage substantially the existing mechanisms for the sharing of experience and so encourage more rapid dissemination of new and promising ideas and the more effective exchange of experiences and lessons.

123. These benefits are likely to be particularly important in the current environment in which important new dynamics, such as the growth of private sector regulatory activity and attempts to apply regulatory quality disciplines to regulation within government, are being identified. Limited progress has so far been made toward understanding the implications for these dynamics and toward developing responses that are consistent with the existing regulatory policy objectives.


OECD (2002). Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance

OECD (2008) Budgeting in Australia


See: OECD (2010a) Value for Money in Government: The Netherlands 2010,


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