

Regulatory Policy at the Crossroads

Some remarks to the OECD's final plenary¹

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This concluding session of what has already been a valuable conference is directed at learning from the past experiences of different countries, to provide a better 'road map' for the future.

So what might be learnt from Australia's experiences? Are we in the 'front runner' category identified by the OECD in its background paper? I think we were indeed a front runner in the latter 1980s and 90s. We then began to slip behind some other OECD countries, like the Netherlands and the UK, before putting in another burst more recently. But I don't believe that we can say that we are yet near the finishing line!

Perhaps the most important thing that Australians have learnt over the years (though with periodic memory lapses) is that poor regulation is costly. It is costly not only in an *economic* sense, but also *socially* and, ultimately *politically*.

The economic costs are not confined to the administrative and compliance burdens related to 'red tape', though these can indeed be burdensome. (My organisation estimated that removing the unnecessary cost burdens associated with regulation would raise Australia's GDP by nearly 1 ½ per cent.) Even larger costs arise from the misallocation of effort, investment and production that poor regulations can induce, and from reduced incentives for people to be innovative and industrious.

Evidence of what it means to liberate an economy from these regulatory distortions can be found in the productivity surge experienced by Australia in the 1990s, following extensive structural reforms from the early 1980s. This saw the incomes of Australian households rise on average some \$7 000 above what they would otherwise have been by the end of the decade. Australia's per capita income ranking globally rose from 18th to 8th. The greater flexibility, adaptability and dynamism of Australia's economy has also held it in good stead since the Global Financial Crisis.

1. Regulatory Policy at the Crossroads: Towards a New Policy Agenda, OECD Conference Centre, Paris, 29 October 2010

If Australia has indeed positioned itself as a 'front runner' on regulation, this can be attributed above all to the systematic efforts we have made to understand the costs of poor regulation and to communicate that to the community as well as to policymakers. A better public understanding of the costs of the status quo is likely to be a pre-condition for durable reform in other countries too.

A second important thing we have learned is that poor regulatory outcomes should not be regarded as aberrations. On the contrary, poor regulation is better thought of as the natural order of things, being much easier to achieve than good regulation. It requires less effort and generally faces less political resistance, especially where certain groups can benefit from it in opaque ways at the cost of the wider community. Regulatory action, even when ill-conceived, is often rewarded with public acclaim, as tangible evidence that government is 'doing something'. These uneven political pressures have often manifested themselves in a 'regulate first, ask questions later' approach - the antithesis of good regulatory process.

Once bad regulation has come into being, however, it can be very difficult to remove or reform. (One experienced Australian politician has asserted that it is 'five times harder' to remove poor regulation than to introduce it!) So actions to discipline the flow of new regulation, as well as tackling problem areas within the existing stock, are clearly desirable. That is why countries need a distinct 'regulatory policy': a policy about *making* policy through regulation. Without conscious, systematic efforts, poor regulation - and poor policies - are inevitable.

Australia's experience confirms, however, that there are no simple prescriptions for achieving 'regulatory nirvana'. Good regulation can only be secured through systems within government that actually foster it - systems that make it harder to regulate poorly than to regulate well. Ultimately what is needed is *cultural* change. The culture within a government influences decisions at both the political and bureaucratic levels, about whether, what and how to regulate, as well as how to administer regulation in place: in short, it exerts influence throughout the whole regulatory cycle. While cultures are not immutable, they are not easily changed and do so only slowly.

As the OECD has highlighted, improved regulatory governance - institutions, processes and leadership - is crucial to better regulatory outcomes.

Australia has been active in this space over recent years, and some of our innovations may have wider relevance, including for an OECD 'road map'. It would be nice to be able to report that all our changes have been successful and sustained. The truth is that while we have certainly had successes, we have also had changes of questionable value and some that have not helped the cause of good regulation. That said, there is now a heightened sense in Australia of the importance of good regulation and a more active debate about how we can do better.

Looking back over the past couple of decades, Australia's greatest successes, in my opinion, have been in reforming existing policies, rather than in preventing poor policies and costly new regulation being introduced. In other words, we have done better in reforming the *stock* than disciplining the *flow*.

Australia has benefitted over the years from having independent institutions and other review processes to identify and make the case for reform. Selling the need for reform to the community, and testing public support for specific changes, has been central to the major structural reform successes of the past. These have taken the form of detailed reviews of key areas of policy or regulation (like the regulatory frameworks for financial markets, public utilities, etc) as well as broader 'search and destroy' missions to address problems across the regulatory landscape (like the Regulation Taskforce that I headed in 2006 and the Legislative Review Program conducted under National Competition Policy from 1995-2005).

A clear lesson from Australia's record of successes and failures in regulatory reform is the crucial importance of consultation. If anything other than 'quantification' deserved its own mantra among regulatory reformers, it would have to be 'consult, consult, consult'. It is essential at all phases of the regulatory cycle: at the beginning, when a 'problem' arises; in the middle, when options are being considered; and, just as importantly, at the end, to rid the devil from the detail. Beyond that, it is also needed to check that regulation is not having unintended effects (which are less likely the more effective the consultation process).

Consultation, when done well, allows government to learn a great deal about problems and solutions and to test its ideas - and to do so without being unduly influenced by particular sectional perspectives. Consultation needs to be wide in its coverage of 'stakeholders' and as transparent as possible.

(As an aside, consultation needs to be distinguished from 'negotiation'. Realpolitik necessitates a degree of political negotiation to get policies enacted and implemented. But if policy proposals have not been well-informed by effective consultation and research in the first place, negotiation has no anchor and is liable to produce undesirable policy outcomes.)

Australia's own record on consultation has been mixed. But the evidence is clear that where it has not been conducted properly, policy proposals have generally not turned out well. There is now a 'whole-of-government' requirement for government agencies to engage in consultation for any new regulatory proposals in accordance with a number of established principles (drawn in part from the UK). It is not clear yet how consistently or well these are being applied.

These form part of broader requirements for regulation impact statements for 'significant' regulatory proposals, which had their genesis in the 1980s. For many years, lip service was paid to those requirements, until they were tightened and sanctions were introduced for failure to comply. The fact that we sometimes now hear complaints from regulatory agencies and policy departments about the 'red tape' *they* face in developing regulatory proposals, suggests that we may have made some progress!

Mechanisms to *entrench* good process are the Holy Grail of regulatory policy. They require both incentives and disciplines. However, political leadership is the key. Without strong support at the top, exceptions soon become the rule. And without the right signals from the top, cultural change can never be achieved at the bottom. But is this asking too much of our political leaders, especially in this era of a 24 hour electronic media cycle that demands daily 'announceables'?

I don't think so. And this brings me to the final lesson from the Australian experience. As a former Australian political leader has expressed it, good process is ultimately good politics. Without it, governments can certainly act more quickly and 'decisively', but poor outcomes will often result, and they will ultimately take their toll. Ironically, the media plays a key role at both ends of the story. Media clamour often forces governments to make hasty regulatory interventions; but, when things go wrong, it is the media that again leads the charge in bringing political leaders to account. (We have seen this play out in Australia very recently.)

This highlights the political, as well as policy importance, of establishing processes, procedures and initiatives, that (to quote an earlier speaker) "create space and time to get the right answers": arrangements that permit governments, in other words, to ask questions *first*, regulate later.

In terms of a 'road map', this suggests that we may need to devote attention not just to *what* needs to be done, but *how* to ensure that it is. What are the incentive structures and institutions that surround regulation making in each country? Are they working? What constitutes 'best practice? (Is there a need for more independent 'gate-keeping'? More resourcing? More sanctions? Stronger political oversight?) This is a direction for further work that is likely to have a promising destination, and one which the OECD is very well placed to advance.