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GENERAL SECRETARIAT

Special Group on Regulatory Policy

2005 POLICY RECOMMENDATIONS FOR REGULATORY QUALITY

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The 2005 Recommendations are presented for approval. They retain the 7 key points of the OECD 1997 Recommendations on Regulatory Reform, but the supporting material has been updated and expanded on the basis of stocktaking exercises carried out in the SGRP and in its constituent bodies in Trade, Public Governance and Competition to draw out the lessons from 20 country reviews. An introduction has been added to the policy recommendations.

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STRATEGIES FOR SUCCESSFUL REFORM: AN INTRODUCTION TO THE 2005 POLICY RECOMMENDATIONS FOR REGULATORY QUALITY

From 1997 to 2005: the evolution of regulatory policy

The 1997 Recommendations have global relevance…

The first set of OECD policy recommendations for regulatory reform was endorsed by Ministers in 1997. They have provided guidance to member countries to improve regulatory policies and tools, strengthen market openness and competition, and reduce regulatory burdens. Once recognized in policy by a few, the importance of regulatory quality is now acknowledged by all member countries and a growing number of developing countries. The APEC-OECD Integrated Checklist for Regulatory Reform, which incorporates the 1997 recommendations, demonstrates the global relevance of the OECD's integrated approach to regulatory capacity, competition and market openness.

but countries must renew their action plans.

The 1997 Recommendations have stood the test of time and experience. Based on the lessons of experience drawn from 20 country reviews and other studies, these recommendations have been carefully examined and updated to help countries face the challenges of the 21st century with a renewed commitment toward better regulation. The original 7 principles have been retained, but the explanatory notes and subordinate recommendations have been expanded. Issues which receive greater attention in 2005 than in 1997 include: policy coherence and multi-level co-ordination; *ex ante* assessment; competition policy and sectors such as network utilities that meet public needs; market openness; and the implementation of reform. The 2005 Recommendations highlight the cross-sectoral, integrative nature of regulatory quality, and especially the dynamic, forward-looking process by which policies, tools and even institutions are adapted.

From a static to a dynamic concept

Regulatory reform is on-going…

The fundamental goal of regulatory reform is to improve national economies and enhance their ability to adapt to change. Regulatory and structural reforms are complementary to sound fiscal and macroeconomic policies, which alone are not sufficient for growth in an increasingly globalised economy. In times of profound and rapid social, economic and technological change, governments have to consider the cumulative and inter-related impacts of regulatory regimes, to ensure that their regulatory structures and processes are relevant, robust and forward-looking. Countries now understand that regulatory reform is not a one-off effort, accomplished once and for all, but a dynamic, long-term, multi-disciplinary and pro-active policy. The country reviews of regulatory reform launched in 1998 and the monitoring exercises of implementation launched in 2004 document the considerable progress that has been made, and identify lessons about implementation that can be shared.

and quality regulation is the goal.

The concept of regulatory reform has changed in the past decade. The focus in the 1990s was on steps to reduce the scale of government, often carried out in isolated initiatives. "Regulatory quality" better captures the thrust of government policy, which now embraces a multi-disciplinary approach to policy coherence, and a whole-of-government approach to implementation that are reflected in the OECD's cross-disciplinary, horizontal programme on regulatory reform.

The lessons of experience applied to the OECD Recommendations

The experience of 20 countries encapsulated in the OECD regulatory reform reviews demonstrates that regulatory reform initiatives contribute to growth by:

Growth is stronger and so is productivity.

- Strengthening product market competition, and easing the adoption of innovative technologies and organisational practices;
- Reducing prices, increasing choice and improving quality for services and products for businesses and consumers such as electricity, transport and telecommunications, and professional services;
- Reducing market access restrictions by eliminating barriers to entry and lowering administrative burdens, thereby creating new businesses and jobs;
- Establishing markets for the private sector to provide services previously supplied directly by the state;
- Strengthening flexibility and innovation;
- Promoting consideration and use of more flexible and efficient instruments such as market-based approaches which, together with regulatory instruments, help maintain efficient levels of protection in areas such as health and safety, the environment and consumer protection.

The changing role of the state…

Regulation is an important policy instrument to shape economic performance and social well-being now that governments have less latitude to use fiscal and macroeconomic policies. Deregulation remains important, and more needs to be done to improve the market framework for network utilities. But government retains a strong role in the provision of services in the public interest, even when many services are partly or largely market-based. Now that governments provide fewer services directly, public service delivery only increases the need for and scope of regulation.

… calls for a more responsive approach to regulation.

Regulatory quality contributes to economic and government performance. Indeed, as economies develop, public expectations in areas such as safety, health, environmental quality, education, and energy security, for which there is a role for government, tend to increase. Experience shows that regulatory reform, if properly carried out, should not adversely affect, and can often promote, such objectives. Economic and social objectives should be mutually supportive, but positive results are not simply automatic. Confronted with greater choice in more competitive markets, consumers may need more information and confidence-building measures. Regulation must be responsive, yet also predictable and stable. More efficient and dynamic economies will also help governments serve these public interests, but governments will need to monitor the social costs and benefits. Linking regulation to broader social and economic public policy goals is key to building and retaining public support for regulatory reform.

To advance further and more rapidly, a comprehensive, forward-looking approach is called for. The ideal remains a coherent and comprehensive approach to improving regulatory systems. Recent experience concerning implementation offers many examples of both success and failure from which policymakers can learn. Key lessons, which transcend the institutional and constitutional differences among countries, highlight:

- Leadership as the most important ingredient for success;
- The role of central regulatory bodies, or of units providing a co-ordinating function;
- Crises as a catalyst for change;
- The benefits of promoting domestic competition and a strong competition culture, and liberalisation of entry into non-manufacturing industries;
- How regulatory quality, market openness and competition are mutually supportive, when regulatory policy is part of a wider framework for policy integration;

Leadership, good governance and efficient markets support regulatory reform.

- The gains that follow from eliminating regulatory barriers to trade and investment when market openness is integrated in the regulatory process;
- The harmful effects of a short-term perspective, insufficient analysis or understanding of complex market structures, and the dangers of "regulatory capture" or clientelism;
- The benefits of and need for well-designed and adequately supported institutions and regulatory bodies, especially in newly privatised and deregulated network utilities;
- The use of regulatory impact analysis to promote more rigorous evidence-based analysis of objectives and of the best means of attaining them, and to support careful consideration of alternatives to regulation;
- The need for more robust forms of public consultation;
- The importance of a communication strategy, because governments face opposition when promoting structural policies and reform, and constituencies to support reform are diffuse and ill-organised.

Towards the future: the 2005 Recommendations for Regulatory Quality

The 2005 Recommendations for Regulatory Quality, taking account of the challenges of the 21st century's first decade, should help countries to improve:

The interface between the public and private sectors

- management of complex policies with multiple objectives, and often-unexpected outcomes;
- the use of alternatives to regulation;
- market conditions with open and transparent competition, and opportunities for trade and investment;
- evaluation of regulations and of their economic and social impacts, ex post as well as ex ante, and monitoring of regulatory authorities;
- risk awareness in transport, energy, health and the environment, as well as the new security agenda;

Institutional frameworks

- greater coherence across levels of government;
- accountability obligations by regulators and compliance with regulatory quality principles;
- integration of competition and market openness in regulatory processes, and communication and collaboration among trade and competition officials, and regulatory authorities;
- stakeholder consultation and public communications within an overall uncompromising commitment to transparency.

Regulation shapes the conditions within which the market economy functions and the public sector meets its responsibilities. Regulatory reform is not a quick fix, accomplished once and for all, nor is it a technical matter. Regulation concerns how governments intervene, and therefore affects the relations between the state on the one hand, and citizens and firms on the other. There are few aspects of public policy that contribute more to strong democratic institutions and to economic opportunity.

2005 POLICY RECOMMENDATIONS FOR REGULATORY QUALITY

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

1. Commit to regulatory reform at the highest political level, recognizing that key elements of regulatory policy – policies, institutions and tools – should be considered as a whole, and applied at all levels of government. Articulate reform goals, strategies and benefits clearly to the public.

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

3. Create effective and credible co-ordination mechanisms, foster coherence across major policy objectives, clarify responsibilities for assuring regulatory quality, and ensure capacity to respond to a changing, fast-paced environment. Ensure that institutional frameworks and resources are adequate, and that systems are in place to manage regulatory resources effectively and to discharge enforcement responsibilities. Strengthen quality regulation by staffing regulatory units adequately, conducting regular training sessions, and making effective use of consultation, including advisory bodies of stakeholders.

4. Encourage better regulation at all levels of government, improve co-ordination and avoid overlapping responsibilities among regulatory authorities and levels of government; apply regulatory quality criteria such as transparency, non-discrimination and efficiency to regulation inside government, and encourage private bodies such as standards-setting organisations to adopt criteria for regulatory quality based on the OECD Recommendations.

5. Adopt a dynamic approach to improve regulatory systems over time to improve the stock of existing and the quality of new regulations, and ensure that reforms are carried out in a logical order and that related markets are liberalised together, where practicable. Make effective use of ex-post valuation.

2. Assess impacts and review regulations systematically to ensure that they meet their intended objectives efficiently and effectively <u>in a changing and complex economic and social environment</u>.

6. Review regulations (economic, social, and administrative) against the principles of good regulation and from the point of view of those affected rather than of the regulator; update regulations through automatic review procedures such as sun-setting;

7. Consider alternatives to regulation where appropriate, including self-regulation, that give greater scope to citizens and firms; when analysing such alternatives, consideration must take account of their

costs, benefits, distributional effects, impact on competition and market openness, and administrative requirements;

8. Use performance-based assessments of regulatory tools and institutions, to assess how effective they are in contributing to good regulation and economic performance, and to assess their cost-effectiveness;

9. Target reviews of regulations where change will yield the highest and most visible benefits, particularly regulations restricting competition and market openness, and affecting enterprises, including SMEs.

10. Review proposals for new regulations, as well as existing regulations, with reference to regulatory quality, competition and market openness; ensure compliance with quality standards when drafting or reviewing regulations preferably overseen by a body created for that purpose.

11. Integrate regulatory impact analysis into the development, review, and revision of significant regulations, and use RIA to assess impacts on market openness and competition objectives; support RIA with training programmes, and with ex-post evaluation to monitor quality and compliance; include risk assessment and risk management options in RIAs. Ensure that RIA plays a key role in improving the quality of regulation, and is conducted in a timely, clear and transparent manner.

12. Minimize the aggregate regulatory burden on those affected as an explicit objective to lessen administrative costs for citizens and businesses and as part of a policy stimulating economic efficiency. Measure the aggregate burdens while also taking account of the benefits of regulation.

3. Ensure that regulations, regulatory institutions charged with implementation, and regulatory processes are transparent and non-discriminatory.

13. Establish regulatory arrangements that ensure that the public interest is not subordinated to those of regulated entities and stakeholders.

14. Consult with all significantly affected and potentially interested parties, whether domestic or foreign, where appropriate at the earliest possible stage while developing or reviewing regulations, ensuring that the consultation itself is timely and transparent, and that its scope is clearly understood.

15. Ensure that firms in an industry are not subject to firm-specific benefits or costs arising from regulation, unless such benefits or costs are demonstrably necessary to benefit the public or to prevent the exercise of market power.

16. Create and update on a continuing basis public registries of regulations and business formalities, or use other means of ensuring that domestic and foreign businesses can easily identify all requirements applicable to them. Electronically accessible, interactive websites should be a priority to make rulemaking information available to the public, and to receive public comment on regulatory matters.

17. Ensure that administrative procedures for applying regulations and regulatory decisions are transparent, non-discriminatory, contain an appeal process against individual actions, and do not unduly delay business decisions; ensure that efficient appeals procedures are in place.

18. Ensure that regulatory institutions are accountable and transparent, and include measures to promote integrity.

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

19. Eliminate sectoral gaps in coverage of competition law, unless evidence suggests that compelling public interests cannot be served in better ways. Competition law enforcement and sector regulation to protect competition and trade liberalisation should be co-ordinated to ensure consistency.

20. Enforce competition law vigorously to check collusive behaviour, abuse of dominant position, and anticompetitive mergers, all of which risk frustrating reform. Employ effective tools to detect and deter hard-core violations. Sanctions imposed against anti-competitive conduct should be sufficient to deter violations; that is, they should be proportionate to the violators' expected gain, the risk of detection and the risk of public harm.

21. Provide competition authorities with the authority and capacity to advocate reform, and support public awareness of the role and benefits of competition.

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

22. Ensure that regulatory restrictions on competition are limited and proportionate to the public interests they serve.

23. Review those aspects of economic regulations that restrict entry, exit, pricing, output, normal commercial practices, and forms of business organization to ensure that the benefits of the regulation outweigh the costs, and that alternative arrangements cannot equally meet the objectives of the regulation with less effect on competition.

24. Promote efficiency and the transition to effective competition where economic regulations continue to be needed because of potential for abuse of market power. In particular: (i) in appropriate cases such as privatisation and the reform of markets that are in the process of opening up to competition, separating potentially competitive activities from regulated utility networks, and otherwise restructuring as needed to promote competition; (ii) promote non-discriminatory access to essential network facilities to all market participants on a timely and transparent basis; (iii) promote inter-connection of networks between geographically neighbouring areas; and (iv) use price regulation mechanisms including price caps and other mechanisms such as price monitoring and disclosure regimes to encourage efficiency gains when price controls are needed.

25. Promote choice by consumers of the firm with which they deal so that they can switch firms at reasonable cost and without undue restrictions.

26. Periodically review the state ownership stake or financial interest in undertakings with market power and whether they unduly impair competition or impede pro-competitive reforms.

27. Periodically review the need for universal service obligations, their effectiveness and the need to maintain restrictions on entry and prices.

6. Eliminate unnecessary regulatory barriers to trade and investment through continued liberalisation and enhance the consideration and better integration of market openness throughout the regulatory process, thus strengthening economic efficiency and competitiveness.

28. Better integrate the consideration of market openness principles within the design and implementation of regulations and the conduct of RIAs, taking account of the increasing role of domestic regulatory environments in determining market openness in light of advances in trade and investment liberalisation.

29. Implement, and work with other countries to strengthen, international rules and principles to further liberalise trade and investment paying particular attention to transparency, non-discrimination, avoidance of unnecessary trade restrictiveness, harmonisation towards international standards, streamlining of conformity assessment procedures and application of competition principles from an international perspective.

30. Reduce as a priority matter those regulatory barriers to trade and investment arising from divergent and duplicative or outdated requirements by countries.

31. Support the development and use of internationally harmonised standards as a basis for domestic regulations and their review and improvement in collaboration with other countries, to assure they continue to achieve their intended policy objectives efficiently and effectively.

32. Elaborate clearly defined criteria for accepting foreign standards, measures and qualifications as equivalent to domestic ones when they pursue the same regulatory objective. Provide transparent and accessible avenues for foreign producers and service suppliers wishing to demonstrate equivalence.

33. Expand recognition of other countries' conformity assessment procedures and results through, for example, mutual recognition agreements (MRAs), unilateral recognition of equivalence, promotion of supplier's declaration of conformity or other means. Encourage the development of domestic capacity for accreditation and ensure its ease of access.

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

34. Apply principles of good regulation when reviewing and adapting policies in areas such as reliability, safety, health, consumer protection, and energy security so that they remain effective, and as efficient as possible within competitive market environments; pursue liberalisation when the benefits of competition and market openness are consistent with the achievement of other key policy objectives; broaden the scope for regulatory quality to include public services. Recognize that as policy objectives multiply, the task of designing and evaluating regulations becomes more challenging.

35. Assess risk to the public and to public policy in a changing environment as fully and transparently as possible, thereby contributing to a better understanding of the responsibilities of all stakeholders.

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

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