Chapter 2

What Are Good Regulatory Practice, Responsive Regulation, and a Well-Performing Regulatory Management System?

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Chapter II

What Are Good Regulatory Practice, Responsive Regulation, and a Well-Performing Regulatory Management System?

Regulation, and with it regulatory policy, is one of the three central levers of government power, together with currency (monetary policy) and taxes and expenditures (fiscal policy). As such, regulation is critical in shaping the welfare of economies and societies (OECD, 2010, p.5). As the Organisation for Economic Co-operation and Development (OECD) report emphasises (Ibid., p.7),

> *Modern economies and societies need effective regulations to support growth, investment, innovation, market openness and uphold the rule of law. A poor regulatory environment undermines business competitiveness and citizen's trust in government, and it encourages corruption in public governance.*

The challenge is to ensure that regulations address the failings of the market system (e.g. negative externalities of production and consumption, asymmetric information) while preventing regulations to be a source of unnecessary burden to firms and citizens (that can arise from poorly designed, poorly implemented, and inconsistent regulations) or of regulatory capture. GRP and a well-performing RMS engender effective and efficient regulations.

2.1. Good Regulatory Practice

GRP is underpinned by the following principles, drawing from the principles adopted by Malaysia (MPC, 2014) and New Zealand (New Zealand Treasury, 2012)[2]. Thus, in the Malaysian core GRP principles, the design and implementation of regulation (s) need to:

- **Be a proportionate and targeted** response to the risk(s) that a (set of) regulation(s) address(es);

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[2] Other versions of GRP include the Asia-Pacific Economic Cooperation (APEC)–OECD Integrated Checklist on Regulatory Reform and the APEC Principles to Enhance Competition and Regulatory Reform; see http://www.oecd.org/gov/regulatory-policy/recommendations-guidelines.html

- **Minimise adverse side effects** to achieve regulatory goal at least cost;
- **Have a flexible and responsive approach** to allow regulators to adopt least cost and incentivise compliance with regulation;
- **Have consistency** in design, interpretation, and application of and among regulations, **without duplication and overlap;**
- **Have transparency and predictability** arising from regular consultation of interested parties, easy accessibility of information on regulations, clarity of legal obligations of the regulated entities, and mechanisms engendering predictability of regulatory regime over time;
- **Have accountability and probity** provisions to reduce corruption.

In addition, the New Zealand formulation of its 'best practice regulation model' indicates the following principles:

- **Be a durable regulatory regime** capable of responding to changing circumstances;
- **Have capable regulators** and efficient systems for effective RMS; and
- **Be supporting of economic growth.**

As is apparent from the Malaysian and New Zealand cases, the specification of what makes for a GRP (model) may differ somewhat, but the core principles indicated in the Malaysian GRP principles are virtually common, reflecting the essence of GRP.

It may be noted that the characteristics of 'smart regulation' propounded by the World Bank in its Ease of Doing Business Report 2014 are very similar to the GRP principles stated above:

S – for streamlined:	that is, regulations that accomplish the desired outcome in the most efficient way
M – for meaningful:	that is, regulations that have a measurable positive impact in facilitating interactions in the marketplace
A – for adaptable:	that is, regulations that adapt to changes in the environment
R – for relevant:	that is, regulations that are proportionate to the problem they are designed to solve

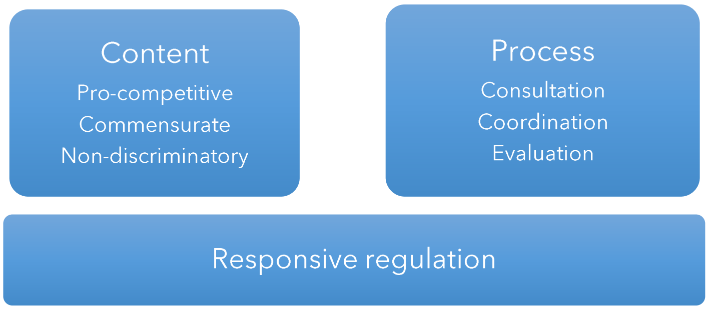
T – for transparent: that is, regulations that are clear and accessible to anyone who needs to use them.

2.2. Responsive Regulation[3]

Figure 2.1 presents a framework of responsive regulation, in terms of both content and process. In terms of **content**, regulations should ideally be

- pro-competitive,
- commensurate with objectives, and
- non-discriminatory.

Figure 2.1: Elements of Responsive Regulation



Source: Dee (2013).

Where government interventions are required to deal with market failures, they should generally do so in a way that does least damage to competition. This requires interventions to be targeted only at the particular markets where problems occur. It also requires that if competition in regulated markets is constrained by policy choice, anti-competitive behaviour is not able to spill over to neighbouring markets.

Governments often have additional objectives besides economic efficiency. Where interventions are designed to achieve other objectives, it is important that they do not unduly compromise economic efficiency. Multiple objectives require multiple regulatory instruments, so it is important that the appropriate *number*

[3] This subsection is taken virtually as a whole from Intal et al., 2013.

and *type* of regulatory instruments are chosen. And once chosen, the interventions should not be more burdensome than they need to be to achieve their objectives.

As much as possible, interventions should not prejudge either the *number* or the *identity* of players in a market. And they should not create an uneven playing field. They should not give undue advantage to government-owned enterprises relative to private enterprises, to domestic enterprises relative to foreign-owned enterprises, and to incumbent enterprises relative to new entrants.

In terms of **process**, ideally, such regulatory interventions should involve

- consultation (with all stakeholders),
- coordination (within government), and
- evaluation (ex ante and ex post).

Broad consultation with all stakeholders can help disclose who gains and who loses from an intervention, and the likely magnitudes of those gains and losses. This information is vital in establishing the case that the intervention will produce a net gain to the community as a whole. Accordingly, it is important that the consultation be with all stakeholders, not just those whose privileged position might be threatened by the intervention. Such consultation provides an opportunity for the special pleading of these special interests to be set against the broader benefits to other stakeholders.

The scope of desirable economic interventions may not line up neatly with the portfolio responsibility of a single government department. Ministries themselves are often stakeholders whose bureaucratic position may be affected positively or negatively by an economic reform. And successful implementation may require the cooperation of more than one ministry. The views of ministries as stakeholders need to be heard and understood, and their cooperation needs to be secured. This requires coordination.

New interventions need to be evaluated before they are implemented to ensure that they have the best chance of generating a net gain to the community. New interventions can also be evaluated after they have been in place for a time, to ensure they are operating as intended. And long-standing interventions also need to be evaluated to ensure they have not outlived their usefulness. Such evaluations require consultation, but they also require careful analysis of the costs and benefits to various groups, and careful judgment as to where the balance of net benefit to the community lies.

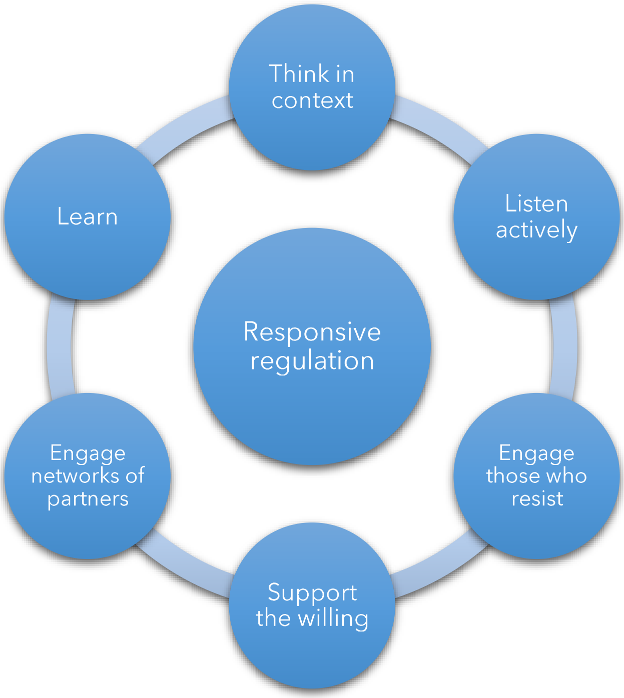
The literature on ***responsive regulation*** stresses that consultative processes are not only critical in the design phase, for example, through formal processes such as Regulatory Impact Analyses (RIAs) but also critical on an ongoing basis to ensure compliance with regulation, and to learn when current interventions are not working or have outlived their usefulness.

Braithwaite (2011) argued that regulation needs to be responsive to the moves that regulated actors make to industry context and to the environment. While responsive regulation is sometimes identified narrowly with the concept of a sanctions pyramid (that is, try the least coercive enforcement methods first, and escalate up the pyramid only as necessary), Braithwaite (2011) identified broader principles that are relevant here **(Figure 2.2).**

Thinking in context means pretesting theories 'on the ground' with real participants. *Listening actively* gives a voice to stakeholders. *Engaging those who resist* shows them respect by allowing their resistance to be used as an opportunity to learn how to improve regulatory design. *Support and education* can be used to build a common understanding of the rationale for regulation, and to build the capacity and motivation to comply. In resource-poor countries, it can be particularly useful to *engage wider networks of partners*, such as industry associations and non-government organisations, and co-opt them into the design and enforcement of regulation (e.g. development of industry-based accreditation programmes and industry-based training). Drahos (2004) made this argument on resource grounds, but Braithwaite (2006) also noted that it can be useful to guard against regulatory capture. Finally, it is critical to *learn* – to evaluate how well and at what cost outcomes have been achieved, and to communicate the lessons learned.

Implicit in responsive regulation is strong private sector engagement and stakeholder-centric regulatory review, monitoring, and redesign in an integrating ASEAN and East Asia region. Responsive regulation may involve relatively 'soft' styles of control that may be difficult to put through a RIA process.

Figure 2.2: Responsive Regulation Process Principles



Source: Dee (2013).

In addition, a responsive approach is also likely to pick up on new risks and risk creators, thereby avoiding one of the criticisms of purely risk-based regulation – that while seeking greater efficiency, it tends to focus on known and familiar risks. Moreover, a responsive approach is likely to be sensitive to industry differences, and therefore not take the same approach to controlling small and medium enterprises as to multinationals, for example (Grabosky, 1995). Finally, responsive regulation needs to be responsive to *changes* in objectives, priorities, and circumstances. Baldwin and Black (2008, p.75) recognised that this involves a challenge:

> *There are real dangers that networked, smart, regulatory regimes lock their involved actors into agreed positions and approaches so that salutary reforms cannot be brought into effect. In an ideal world, conversations between networked regulatory actors might be expected to produce regulatory adjustments. In a less than ideal world, such conversations may lead to confusions, entrenched positions, and inability to respond to regulatory*

failures and blame shifting. What may be needed are strategies for encouraging appropriate programmes of modification.

One such strategy is to hold ***informed regulatory conversations***, which are ***mediated*** conversations between networked regulatory actors. The presence of a mediator who can act as an 'honest broker' can help break through entrenched positions, not just to identify better options but also to build a consensus in favour of reform.

2.3. Regulatory Management System

The GRP principles and responsive regulation discussed above are woven together and take implementation shape through the RMS. RMS is the body of principles, policies, practices, processes, institutions, and institutional mechanisms that apply to the review of existing regulations and the development of new regulations. Gill (2016) differentiated between the formal RMS from the requisite RMS. The former refers to the '...set of special measures that apply to the development of new or the review of existing regulations but do not apply to other policy interventions'; the latter refers to '...the full set of functionality that is needed in a high performing or ideal system.' It is apparent that the discussion in the previous two subsections is related more to the ideal processes and outcomes that are expected of the ideal or well (high) performing or quality RMS.

Each country has its actual formal RMS of making and reviewing its laws, regulations, rules, and procedures. At the same time, countries are increasingly concerned at improving their regulatory policies and processes and at strengthening their institutions to improve their regulatory outcomes, given the growing evidence that institutional factors significantly impact on investment, trade, and growth performance. Some OECD countries, of which Australia and New Zealand have been important trailblazers, and the OECD as an organisation have been at the forefront of innovation, implementation, and research towards well-performing RMS. That is not to say there is a common OECD way. As discussed below, different OECD countries have adopted quite distinctive approaches to regulatory management.

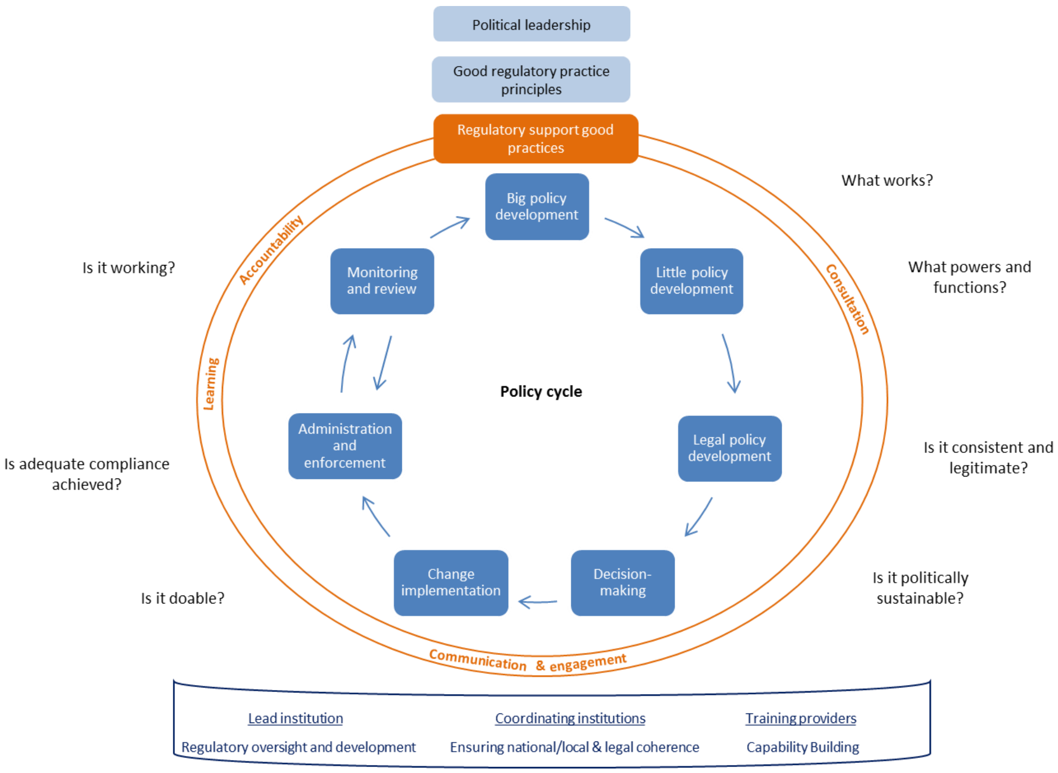
At the same time, it is worth highlighting that Singapore, a non-OECD member, has been consciously improving its overall public service system and in the process increasingly instituting and embedding the GRP principles in the whole public service over the past few decades. The end result has been superior regulatory outcomes, as the global governance and ease of doing business (EODB) indicators suggest, without necessarily having a full-on RMS structure in place. The case of Singapore may be unique in that it is a small city state that is heavily integrated in the regional and global economies and with barely any natural resource to rely on. Nonetheless, it suggests that a country's RMS is 'context specific' to the culture and institutions in the country, but must embed GRPs and responsive regulation principles and processes for it to be well performing as well.

Figure 2.3, drawn from Gill (2016), presents the elements of the requisite RMS. The requisite RMS include policy (cycle) components, practices, and institutions, and an overall regulatory strategy.

The innermost cycle in **Figure 2.3** shows the *policy cycle* of policy development ('big', 'little' or 'operational', and 'legal'), decision-making, change management, administration and enforcement, and monitoring and review. The components of the policy cycle are augmented by *supporting practices* of consultation, communication and engagement, learning and accountability, and transparency. Note that the discussion above on the responsive regulation processes (**Figure 2.2**) elaborates on the consultation, communication, engagement, and learning supporting practices in **Figure 2.3,** whereas accountability and transparency are central elements of GRP discussed above. The policies and practices would require *key supporting institutions* for sustainability; these include coordinating institutions (with mandate to oversee the performance of the regulatory system), lead institutions (that ensure national and legal coherence), and training institutions (to build capabilities of the bureaucracy especially). The figure shows the overarching regulatory strategy of explicit economy-wide policy of embracing GRP principles and sometimes linked to competition and trade policies (see Gill, 2016).

At the end of the policy cycle, the main question is whether the policy intervention, as designed and implemented, is in fact working. For the latter, a menu of stock management tools that have been used, including the regulatory guillotine and the RURB (reducing unnecessary regulatory burden) approach. Regulatory guillotine is meant to eliminate redundant or unnecessary regulations, whereas the RURB approach aims largely to improve the design or implementation of regulations.

Figure 2.3: Elements Required for a High-Performing RMS



Source: Gill (2016).

The discussion above shows that GRP, responsive regulation, and well-performing RMS are interdependent. A well-performing RMS needs to be underpinned by the overarching GRP principles and characterised to a large extent by responsive regulation processes. In addition, the challenge for a well-performing RMS is to ensure that the regulatory outcomes are pro-competitive, commensurate with objective, non-discriminatory, and are embodied in the 'content' of responsive regulation and, to some extent, GRP principles.

It is worth noting that the first point or the end points of the policy cycle have been the initial focus of many OECD countries in their drive towards a requisite RMS. That is, a number of OECD countries have focused on improving their stock of regulations and procedures (with special focus on reducing red tape), whereas some other OECD countries focused initially at improving their systems for new regulations. Nonetheless, over time there is some convergence among the countries in dealing with the stock of old regulations and with the process for the new regulations.

RMS stages development framework. The discussion above focuses on the elements of the ideal RMS in conjunction with GRP principles and responsive regulation. In many cases, however, the actual RMS of many countries can be expected to differ from, and indeed could be far from, the ideal RMS. Moving from the actual RMS to an ideal RMS is not easy and would take many years or even decades; neither is it linear as there could be setbacks, reversals, or hiatuses. This is because the challenge can be of a major transformation of the bureaucracy and the overall decision-making process in the government.

A stages 'model' of RMS development is presented below, drawing from the experiences of the selected East Asian countries in the project of the Economic Research Institute for ASEAN and East Asia (ERIA) and the New Zealand Institute of Economic Research (NZIER). The quality regulatory management has the following stages or levels:

- **Starter or Informal** – ad hoc practices that are specific to the context, sector, organisation, and person undertaking the regulatory quality management function
- **Enabled** – regulatory quality management processes have been put in place; although the intention is there, regulatory quality management does not happen consistently
- **Practised** – enacted in some sectors and often reliant on a few key people in selected institutions
- **Embedded** – practices are part of the public sector culture and not reliant on key institutions.

This stages model draws on the practitioner literature on Capability Maturity Models (CMM) developed initially in the information technology industry but increasingly applied to a range of change management processes. The CMM broadly refers to a process improvement approach that is based on a process model. Maturity models can have up to five levels, where level one typically represents an ad hoc state and a very low level of maturity and level five represents the highest level of maturity and continuous process improvement. A maturity level represents a new level of capability within a system or organisation created by a change in one or more core processes.

A review of the maturity model literature suggests that the use of maturity models to support change from process improvement produces several outcomes. In general, three changes that can be expected are *predictability, increased control,* and *improved effectiveness*. The use of a maturity model helps an organisation transition from firefighting to operating according to plan (Kipta and Berge, 2006).

A number of components vary as capability matures. Thus, the leadership imperative varies:

- Moving from 'starter or informal' to 'enabled' requires leadership that focuses on putting processes in place and managing the pressures around take up
- Moving from 'enabled' to 'practised' requires leadership that focuses on developing systems and a culture with a shared view on goals and processes
- Moving from 'practised' to 'embedded' requires leadership that is focused on reinforcement and learning so organisations and their staff know the script and how to respond without so many formal instructions.

The extent of measurement also varies as capability matures:

- At the starter or informal level, measurement is rudimentary. Practices processes are not rigorously planned and tracked. Performance depends on individual knowledge and effort.
- At the enabled level, processes are planned and tracked and increasingly documented as organisation-wide standards.
- At the practised level, measures of performance are collected and analysed, leading to a quantitative understanding of process capability.
- At the embedded level, processes undergo continuous refinement and improvement with effectiveness and efficiency targets established based on organisational business goals.

Fundamentally, what is under way is a shift from explicit controls (enabled and practised) to the embedded phase which uses implicit control based on cognitive cultural values (Scott, 2001).

Table 2.1 presents the stages or levels of RMS development in terms of the coverage and implementation of the RMS. In terms of the RMS coverage of economic sectors, government institutions and elements of the RMS, the coverage runs from partial and limited coverage under 'starter or informal' to virtually the whole economy and all government institutions (excluding sensitive areas like defence) and all RMS elements under 'embedded.' In addition, under 'embedded', the coverage of RMS would include at least a majority of the subnational local government units, especially states under a federal form of government which tend to have significant regulatory powers of their own compared with local government units in centralised governments.

Table 2.1: Stages or Levels of RMS Development (Classification of RMS Stages)

	Starter	Enabled	Practised	Embedded
Coverage				
Sectors	Partial	Partial	Majority	All
Institutions/	Partial	Partial	Majority	All National
Geography	National	National	National	Most State
Elements	Some	Majority	All	All
Implementation of Elements				
Generic	No	Mixed	Yes	Yes
Discretionary	Yes	Mixed	No	No
Stock/Flow Process				
Regular Stock Review	No	No	No	Yes
Coverage of stock review	Sectoral	Sectoral	All	All
RIA/RIS in flow	Sometimes	Sometimes	Always	Always
Lead Institution				
Central Oversight	No	Mixed	Yes	Mixed
Distributed	Yes	Mixed	No	Mixed
Commitment to GRP and Quality RMS in Practice				
Political leaders	Incipient	Limited	Widespread	Full
Bureaucracy	Incipient	Limited	Widespread	Full

RIA = Regulatory Impact Analysis; RIS = Regulatory Impact Statement; GRP = Good Regulatory Practice; RMS = Regulatory Management System.
Source: Authors.

Table 2.1 shows differences in the nature of implementation of the elements of RMS according to the different levels of RMS development. We define 'generic' as mandatory to the policy development process and therefore a generic regulatory management instrument. In contrast, 'discretionary' means not mandatory and is done on an ad hoc basis at the discretion of the ministry or department. 'Mixed' means the implementation of some RMS elements is mandatory or generic whereas others are discretionary. As the table indicates, the implementation of RMS elements is discretionary at the starter or informal level, but becomes generic or mandatory at the 'practised' and 'embedded' levels.

In terms of stock and flow process, although there is a review of stock of regulations, it is not regular except under 'embedded' stage, although there can be significant review and guillotine of regulations in the earlier levels. The coverage of review of stock of regulations tends to be sectoral or limited to certain regulatory processes like administrative procedures at the earlier stages. The coverage is extensive under both 'practised' and 'embedded' levels. In addition, RIA for significant regulatory proposals and Regulatory Impact Statement (RIS) for minor regulatory changes – either put formally (especially for significant regulatory proposals) or informally (in the sense that the essential features of RIA are followed but without a formal RIA report), especially for minor regulatory proposals – are almost *de rigueur* under 'practised' and 'embedded' stages.

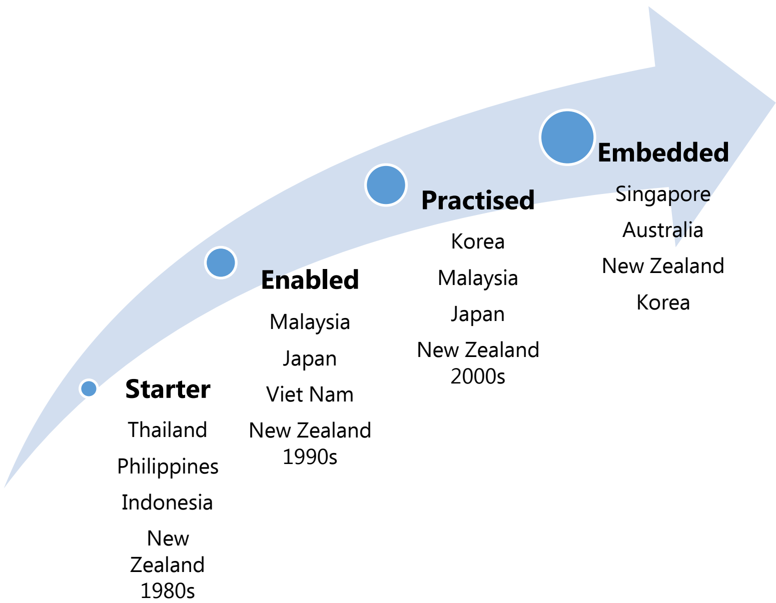
In terms of lead institution, there is no central lead institution under 'starter or informal' level but it is an important element under 'practised' level. Interestingly, at the 'embedded' level, the lead institution can be a centralised or a decentralised system. This is because control is now implicit under 'embedded' in the sense that each ministry and other government bodies follow GRP and responsive regulation principles and practices; as such, there may be no need for a centralised lead institution to ensure the quality of the new regulations or revisions of stock of regulations.

Finally, what also differentiates 'embedded' from 'practised' is that under 'embedded' there is full acceptance of and commitment to implementing GRP and a high-performing RMS by the political leadership and the whole bureaucracy; that is, GRP and quality RMS are fully embraced and embedded in the whole public service.

The discussion above and **Table 2.1** present essentially a static typology of RMS rather than a full model that explains the dynamics of movement from one stage or level to another. The study did not examine the possible factors that determine the dynamics of stage development as well as stasis or even retrogression. Such determination and analysis of the factors would have to wait for future research. Nonetheless, the experience of the selected East Asian countries in the study suggests that economic crisis (e.g. Korea), a realisation of a secular loss of competitiveness (e.g. New Zealand), a national drive at improving its investment attractiveness consistent with deeper international linkages (e.g. Viet Nam), and competitiveness amid rising wage rates (e.g. Malaysia, Singapore) appear to have been important drivers of a vigorous and sustained push at improving regulatory policies and RMS, and thereby move up the levels of RMS development. The succeeding chapter, **Chapter III,** discusses the evolution and status of RMS in the selected East Asian countries. **Chapter IV** provides some important insights drawing from the experiences of these countries.

Finally, **Figure 2.4** presents a preliminary classification of the selected East Asian countries in terms of the typology of RMS stages or levels. As indicated in the figure, Singapore, New Zealand, and Australia are in the 'embedded' RMS stage; Indonesia, the Philippines, and Thailand are still in the 'starter or informal' stage pending effective implementation of recent policy initiatives, whereas Viet Nam is in the 'enabled' stage. Japan, Malaysia, and Korea are in the transition process: from 'enabled' to 'practised' for Japan and Malaysia, and from 'practised' to 'embedded' for Korea. As such, they straddle two stages in the figure. Note that, based on the experience of New Zealand indicated in the figure, the development towards a well-performing RMS is a long process that takes decades. RMS development can also get stalled or accelerated, which brings out the importance of political commitment given that RMS development usually covers more than one administration. The evolution and status of RMS in the selected East Asian countries are discussed in the next chapter.

Figure 2.4: Classification of East Asia Countries according to RMS Stages



RMS = Regulatory Management System.
Source: Authors.