Regulatory reform, capture and the regulatory burden

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Some questions

- what theoretical reasons are there to suppose that regulation tends to be excess *in aggregate*?

- what empirical evidence is there to connect higher regulation with lower economic performance and growth?

- when to regulate? What is the *optimal* level of regulation?

- how to regulate? What are the appropriate instruments and which institutions?
Theory

- the pervasive idea is *regulatory capture*

- regulation is a *public* good
  - indeed, markets cannot function without it. It also protects liberty and equity—and therefore regulatory reform is political

- in the principal–agent framework, objectives differ and so does information. Capture is the manipulation of information to pervert the public interest, where objectives differ

- picking losers, entry prevention, rent capture and risk shifting are part of the regulatory game
Evidence—the causality

- a casual theory for regulation $\rightarrow$ economic growth $\uparrow \downarrow$

- regulation as a tax ($\uparrow$ costs)

- regulation $\rightarrow$ \begin{align*}
    \uparrow \text{R&D} \\
    \uparrow \text{education}
\end{align*} $\rightarrow$ endogenous growth $\uparrow$

- regulation assigns equity risk, protecting sunk costs
Empirical issues

- lack of data—amazing, given the claims made!
- regulation is heterogeneous—aggregates almost meaningless
- sector-specific data (e.g., energy, environment)
- the crude standardised cost model (SCM)
- (questionable) administration, policy and other costs (and benefits) distinctions
- absence of counterfactuals

Example: the cost of capital, risk and utility regulation
When, what, and how?:
the disaggregated approach

- cost–benefit analysis and its proxies
- the five principles of the Better Regulation Task Force
  - who (and what) can violate them?
- market-based instruments minimise capture
- institutional credibility and commitment reduce political and regulatory risk, and, hence, cost of capital
So what? . . .

- ‘one in, one out’ makes little sense
- aggregate regulatory reduction targets are (almost) meaningless and may be counterproductive

But there is an excess regulation problem (often driven by industry)

- the core idea is regulatory capture
- avoiding capture should be a major priority of public policy design
- market-based instruments radically reduce the scope for capture
- the design of institutions matter greatly


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