

COMPETITION AUTHORITY

Submission in response to the Consultation Document “Towards Better Regulation”

Submission No. **S/02/001**

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EXECUTIVE SUMMARY

In this submission, the Authority outlines the fundamental importance of competition in markets. It points out that, in the economic regulation of a sector (i.e. restrictions to entry, pricing and service), which is the main focus of this submission, the rationale for Government intervention, whether by direct regulation or by market-based methods such as targeted taxes or subsidies, must be based on addressing market failure – in particular, market power. Regulation is often used to deal with the effects of market power, but inappropriate regulation can, in itself, create market power. The submission outlines the need for review in Ireland, leading to the OECD Review of Regulatory Reform (2001).

The positive effect of competition on consumer welfare is considered. It is noted that while this implies the need for reform of regulations that unduly restrict competition, recent research in Government Departments and Offices has indicated that the dismantling of some outstanding examples of barriers to market entry has not yet begun because it is not perceived as a priority.

In relation to independent sectoral regulators, the optimal industry structure involves a clear separation of the potentially competitive elements from the monopoly ones. Co-operation between the Competition Authority and the sectoral regulators must continue to deepen and this will be fostered under the Competition Act 2002. It is argued that sun-setting and exiting strategies are appropriate in areas where the removal of legislation is feasible. A single regulatory authority might be envisaged in the long run but, in the meantime, there is merit, where appropriate, in adding new tasks to existing regulators rather than setting up new regulators' offices.

With regard to the analysis of the effect of proposed regulations, it is argued that consultation be broad (not confined to producer interests) and that use be made of tools such as Regulatory Impact Assessment (RIA). Finally, it is argued the proposed National Policy Statement on Regulation be used as a guide for policy makers, and that the High Level Group on Better Regulation continue its vital role in ensuring that the urgent task of regulatory reform is carried out.

The National Policy Statement on Regulation should therefore include:

- a statement of the reasons for economic regulation and the possible instances of market failure (see Section 2);
- a strong reference to the benefits of better regulation (see Section 4.1)
- economic principles for good regulation (see Section 4.2);
- guidelines for analysing the effects of proposed regulation (see Section 4.4);
- and
- recommendations for review and “sunsetting” of regulation (see Section 3.3.4).

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1 INTRODUCTION

This submission is made in response to the Department of An Taoiseach's Consultation Document "Towards Better Regulation", published in February 2002. The Consultation Document was prepared in the light of the OECD Review of Regulatory Reform in Ireland, which was published in April 2001. The OECD report contains a number of specific recommendations, which if followed, will help to ensure that the Irish economy builds upon recent gains.

Questions for consideration are arranged in the Consultation Document within each of the three main areas outlined below:

- Economic performance and consumer welfare;
- Quality of governance; and
- Public service efficiency and effectiveness.

It is recognised in the Consultation Document itself that these areas are inter-related and that exact distinctions between them are not possible¹. The Authority's submission is focused on the overall goal of better regulation, rather than necessarily being restricted to the arrangement of the specific questions in the Consultation Document. However, the Consultation Document's three main areas are addressed in this submission, with "Economic performance and consumer welfare" being dealt with under the heading of "Rationale for regulation and the importance of competition".

2 RATIONALE FOR REGULATION AND THE IMPORTANCE OF COMPETITION

The term "regulation" describes the diverse set of instruments that Governments use to regulate the economic and social activities of citizens and organisations. Instruments include Acts of the Oireachtas, statutory instruments, orders, licences, administrative practices and local authority rules. Regulation of economic activity can deliver benefits when it is proportionate and is specifically designed to address market power or some other recognised failures of the market system to produce optimal outcomes for society. Inappropriate regulation can, however, be inimical to the interests of consumers, producers and society at large. In particular, this can occur where competition is restricted in a manner that is disproportionate to the desired objective or where there is no clear public policy objective in the first instance. Other costs associated with inappropriate regulation include the costs to society of distorting incentives and disproportionate administrative burdens.

¹ Consultation Document, *Towards Better Regulation* at p 64.

2.1 The Fundamental Importance of Competition

Consumer welfare is linked intrinsically to competition, which is the lifeblood of a dynamic economy. Competition forces firms to search for efficiency and gives an incentive to innovate and to be more responsive to consumer needs. Increased competition delivers both once-off and ongoing gains. The once-off gains can be seen in lower prices and increases in value, quality, service and output. The ongoing gains arise because firms' need to continually respond to increased competitive pressure ensures that they drive innovation through their work processes and final outputs. In a competitive market, firms that fail to innovate are not likely to prosper in the long run.

Firms do not necessarily act in this manner because they like competition. In fact, it is likely that firms would prefer not to have competitors at all (or, at a minimum, they would be blessed with ineffective ones). Profit maximisation is a perfectly valid goal for each firm; but competition forces them to behave as if they had a greater purpose in mind, to be responsive to their customers' needs and to strive to find advantage by innovation. As Adam Smith remarked in the *Wealth of Nations* (1776):

“An individual generally neither intends to promote the public interest nor knows by how much he is promoting it...he intends only his personal gain, and he is in this aim...led as if by an “invisible hand” to promote an end which was no part of his intention.”

In sectors such as telecommunications, air transport and taxis, the experience of deregulation has been positive despite the dire scenarios predicted by vested interests. Consumers here have seen the extraordinary benefits that have resulted from the partial liberalisation of aviation in the late 1980's. In the first six years of this partial liberalisation, passenger traffic had risen by 60%, there was an additional 25,000 additional jobs in the tourist industry and a resulting £0.5bn extra tourist revenues². Developments since then have driven down fares even further, clearly with an enormous impact on numbers of passengers, employment and tourism revenues. Similarly, competitive sectors of the telecommunications industry have seen prices reduce and services improve. The ODTR has noted substantial increases in mobile penetration even up to the last two years, with penetration rising from 50% to 79%. This has been accompanied by decreasing prices and an expansion on services³. Fixed line charges have fallen substantially over the years; even where incentive regulation in the form of the 'Consumer Price Index minus X' cap has been applied, consistent cost savings have resulted in prices dropping substantially below the price caps. In the year to March 2000 the cost of calls to the US fell by 23%, calls from Dublin to Cork by 4% local calls by 17%⁴. Service levels have improved enormously since the days of monopoly, when customers had to wait for years to get telephone lines installed.

² Speech by Sean Barrett to Irish Centre for European Law, 23 February 2001.

³ ODTR press releases, 13th March 2002 and 22nd March 2000.

⁴ ODTR press release, 22nd March 2000.

In the transport sector, the removal of quantitative entry restrictions in the taxi market and the plans for the introduction of competition in the bus market in Dublin constitute momentum for further change. Early indications from the study undertaken by Goodbody's indicate that most customer groups are satisfied with the changes in the taxi industry⁵. The recently released Programme for Government has outlined ambitious plans for the liberalisation of the bus market, which are welcomed and will be supported by the Competition Authority.

2.2 The Need for Regulation: Market Failure

Regulation emerges for a number of reasons. For example, Governments may intervene in markets to pursue objectives such as fairness and equity, macroeconomic stabilisation, the promotion of culture, the maintenance of national security, as well as for reasons connected with environmental, health and safety standards and consumer protection. The set of instruments open to Government includes fiscal and monetary policy, primary and secondary legislation and specially appointed regulators and agencies.

In the specific domain of economic regulation of behaviour in a sector (i.e., restrictions to entry, pricing and service), which is the main focus of this submission, the rationale for Government intervention should be based on addressing *market failure*. Market failure can arise, *inter alia*, for the following reasons:

- information failure, especially asymmetric information;
- externalities in consumption or production;
- public goods; and
- market power, which is of particular interest from the competition policy perspective.

2.2.1 Information Failure

When buyers and sellers in a market do not have the same information (i.e. there is 'asymmetric information'), the competitive market may fail to produce the socially optimal outcome. In these circumstances regulation can lead to better outcomes for consumers. Legislation on the disclosure of prices and quality can protect consumers. Consumers are likely to have less information about goods than producers. This is even more important the larger and more infrequent the purchase. An example is the requirement for disclosure of APR (the annualised cost of finance) by mortgage lenders, credit card companies etc. Another example is the obligation to inform consumers of potential side effects of drugs. Setting conditions for entry into various professions is another example of a regulatory response to information asymmetry. In the medical

⁵ *Review of the Taxi and Hackney Market, 2001 (Demand and Supply)*, Goodbody Economic Consultants, January 2002.

arena a patient is unlikely to be in a position to assess the competence of a provider of medical services⁶.

In some cases, competition is limited by consumer inertia, which may be based on lack of information. This can be addressed by simple measures, such as requiring the price of a standard measure (e.g. 1kg) of the good to be displayed. In the case of complex goods or services, it may be difficult for consumers to make price comparisons, especially where a usage charge is involved. Some regulators in the UK have provided “ready-reckoner” facilities which allow consumers to make comparisons across providers and choose accordingly.

2.2.2 Externalities

The consumption or production of some goods or services may have positive or negative spill-overs to third parties. For instance, healthy people not only protect themselves from disease, but also confer a benefit on all other people in society as they help to slow the spread of contagious diseases. Innovation by firms is another example of a positive externality. The market system, which only captures private benefits, will lead to an under-provision of goods that have external benefits. To overcome this tendency, there may be direct public provision of basic health care, and innovators may be given limited protection via intellectual property legislation. An example of a ‘negative’ externality is the release by a chemical factory of toxic substances causing water pollution, which causes damage to downstream fisheries. The market system will tend to lead to an over provision of goods with cause external harm. This can be addressed by limits on pollution (enforced by an environmental protection agency) or by the creation of a property right and trade in licences to pollute.

To enhance the benefits of positive externalities, or reduce the impact of negative ones, Government may set up consumption guidelines or emission targets. It may also use market-based mechanisms, such as taxes and subsidies, to induce the optimal consumption or production of the good or service in question. Economic theory indicates that the most efficient way to ‘internalise’ an externality is through taxation or subsidy. In cases where there are *negative* externalities, the appropriate imposition of a tax can substitute for the cost that is not reflected through the market mechanism, thus correcting the tendency to over-produce or over-consume. In cases where there are *positive* externalities, a subsidy may be used to encourage production or consumption of the good or service in question.

2.2.3 Public Goods

Public goods have two unique characteristics. Firstly, they are non-rival in consumption: one person’s consumption of a good does not preclude all others from also enjoying the benefits. For example, a ship using a lighthouse to determine its position at sea does not preclude any number of other ships from doing exactly the same thing. Secondly, public

⁶ In the USA extensive information is available on the record of medical doctors, which helps consumers make informed choices as to which doctors to attend.

goods are non-excludable: it is almost impossible to stop any other person from enjoying the benefits of the public good. An example is national defence: if the country is being protected from attack or invasion, it follows that all residents receive protection (i.e. none are excluded). Competitive markets will fail to produce enough public goods because people will have an incentive to free ride on the expenditure of others. It is impossible to force consumers to reveal how much they value having a public good, as they will always have an incentive to understate their true valuation. To overcome each individual's incentive to "free-ride", public goods are normally financed through taxation. It is normally the case that Governments (rather than private firms) are involved in the provision of such public goods as national defence, policing, street lighting etc. However, given that this does not directly address the market failure, more and more Governments are considering private provision of public goods under franchise contracts etc.

2.2.4 Market Power

Market power is the ability of firms to raise prices above the competitive level. This market power leads to reduced output, quality and variety. This involves both a transfer from consumers to producers and an efficiency loss to society as a whole through losses in consumption and production for which no one is compensated. Some commentators have argued that the pursuit of cost minimisation is not independent of market structure, with monopolies not having the same incentive to produce the greatest amount of output for any given amount of inputs⁷. This extra inefficiency associated with market power is termed x-inefficiency. In addition, there is a growing feeling that in some cases firms with market power have little incentive to innovate, either in their production methods or in the goods and services they sell.

Firms that do not possess market power have an incentive to collude to limit the competition between them. These cartel agreements move society sharply away from an outcome resembling competition to one resembling a monopoly and, as such, they impose a considerable burden on society. That this was the case was recognised by Adam Smith as far back as the 18th century:

“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”

Firms can seek to enhance or protect their market power through collusion, through the pursuit of mergers which may result in a lessening of competition, or through abuse of a dominant position. Competition law, which has been strengthened in Ireland by the enactment of the Competition Act, 2002, is designed to address some of these issues. However, market power can also be created or strengthened by regulation which is either inappropriate *ab initio*, or which has become so with the passage of time.

⁷ Leibenstein H., *Allocative Efficiency Versus x-Efficiency*, American Economic Review, Vol. 56, June 1966.

For instance, in some sectors of the economy, such as the utilities, the Government has traditionally been involved through vertically integrated State monopolies. In electricity, the ESB was the State monopoly in the generation, transmission, distribution and supply of electricity. This market structure was chosen as it was felt that, given the scale economies, the market could only support one firm. However, due to both technological improvements and a refined understanding of the economics of generation and supply, most commentators no longer see the need for monopoly provision at these levels in electricity. A similar situation pertained in areas as diverse as telecommunications, post and transport. In general, to the extent that natural monopoly continues to exist in an industry (e.g. *transmission* of electricity), leading to market power, technological developments can provide the scope for introduction of competition.

In the case of industries that are ‘structurally competitive’, i.e. easy entry, a large number of sellers, few large firms, etc., it is difficult to argue that there is a market power rationale for government intervention. Indeed, market power in such industries may be caused by government-imposed restrictions. An important element of the regulatory reform agenda in Ireland today is to remove much of this type of regulation, as has been done in many other OECD countries.

2.3 Inappropriate Regulation

Inappropriate regulation can lead to substantial costs and inefficiencies. The OECD, in its “Report on Regulatory Reform – Thematic Studies” (1997) provides an analysis of these costs and inefficiencies at a sectoral level. It identifies five ways in which regulation can negatively affect a sector through restrictions to entry, pricing guidelines, restrictions on advertising, minimum or maximum level of service. These include the following:

- Firms can have less incentive to economise on resources
- A lack of competition can result in excess ‘rents’ (i.e. income in excess of what would accrue in a competitive market, implying that prices in the sector are too high)
- Regulations on service and product type can prevent firms from taking advantage of economies of scale, and especially scope in networking
- Regulations can impose high administrative costs on governments, firms and consumers
- There may in some cases be little incentive for firms enjoying significant market power to pursue technological innovations in production or to create or adapt goods and services in response to changing customer needs.

The first and fifth of these are directly related to market power, which was dealt with above. To the extent that regulations create market power, they necessarily lower efficiency and may be linked to a reduced incentive to innovate. In addition, the OECD note that regulation can create rents, prevent firms from gaining the advantages of economies of scale and scope and can lead to disproportionate administrative burdens.

2.3.1 Rents

‘Rents’ arise from a lack of competition, in many cases due to regulations restricting the number of players in a market. Rents create an incentive to lobby and work to retain (or even extend) them. This can be disruptive of the regulatory process, that vested interests gain at the expense of the rest of society. These activities are normally referred to as rent-seeking or directly unproductive activities. The rents created can be very large, as been seen in Ireland in the cases of taxis, pubs and pharmacies.

Before the abolition of quantitative limits on taxi licences in 2000, there were reports of taxi licences in Dublin changing hands for as much as €100,000. This meant that the quantitative limit on entry to the taxi industry led to significant rents on licences. As there were around 2,700 taxi licences in Dublin at the time, the rents amounted to around €270,000,000. The beneficiaries – the taxi plate owners – were few in number, cohesive and well organised in terms of lobbying. The losers - the rest of society - only bore a small part of the burden individually and so were not so motivated to lobby for change. The regulatory system also clearly disadvantaged hackney drivers, a number of whom took their case to the High Court. The judgement in this case [*Humphrey et al v The Minister for the Environment and Local Government et al*], which came after numerous reports and public criticism of the taxi licensing system, has in fact been instrumental in terms of influencing reform through other sectors of the economy (which have been the subject of similar comments). While the outcome is welcome, the process may send a signal that reform will only come through Court action, rather than through regulatory reform.

The difficulty in obtaining change was recognised in the OECD report (2001):

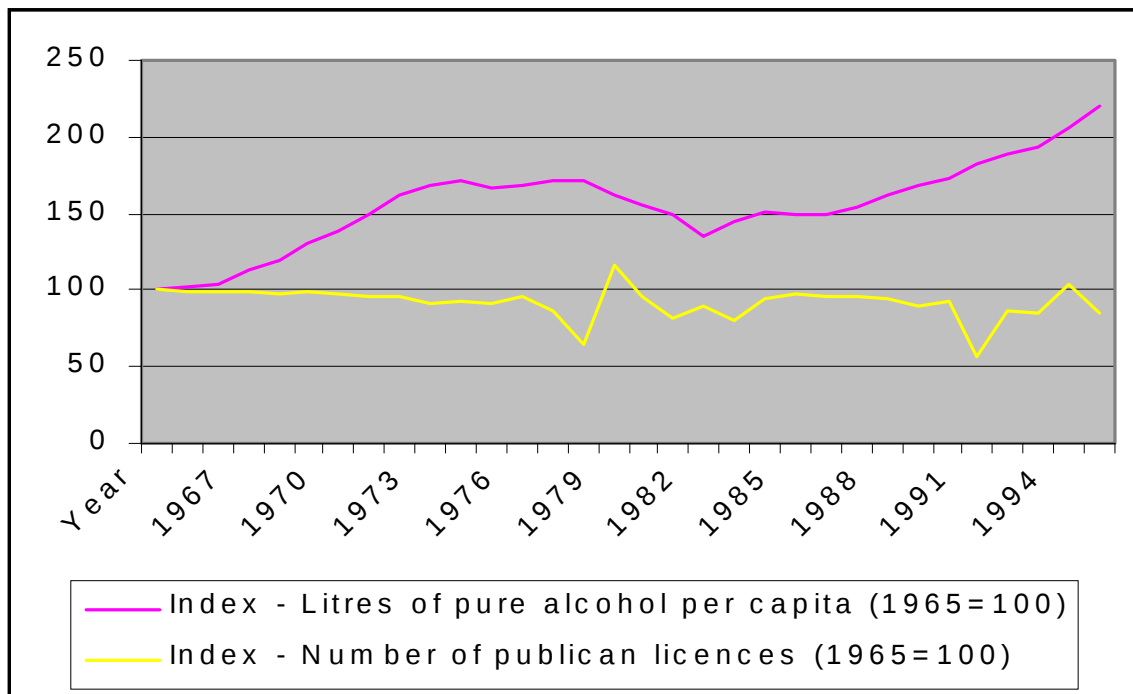
“[d]espite the reforms of the past decade, Irish economic policy remains more favourable to producer interests than to consumers, evidence of an underlying social caution about change, as well as the power of vested producer interests”.

In the case of licences to sell alcohol in the State, the statutory restriction on licences has led to a scarcity value, and, as a result, significant rents payable by buyers to any sellers of existing licenses. This creates a monetary barrier to entry and restricts competition. It also creates both a means and an incentive to engage in intensive rent-seeking behaviour. The OECD (2001, p.32) describes the magnitude of this restriction:

“To open a new pub, a license has to be acquired from an existing pub owner. Around 10,400 pubs are authorised in Ireland. The current value of a pub license is at least €140,000. The capitalised value of pub licences in Ireland is around €1,500 million or between 1.5% and 1.75% of GDP. At current interest rates the cost of remunerating this capital amounts to around 0.3% of the value of personal consumption. At a very minimum this is the potential gain from deregulation, a one-off fall in the consumption deflator of 0.3%.”

Critically, the people who benefit most from this situation - the publicans - couch their arguments for the retention of the restrictive regime in terms of protecting society from the harm of alcohol. Yet, while the number of licences has declined slightly since the 1960s, consumption of alcohol per capita has more than doubled. Other factors, such as rising affluence and societal attitudes to drink, have affected the level of consumption. However, the fact remains that, as shown in Figure 1 below, the current system is not associated with a fall or even a levelling off of consumption:

Figure 1: Trend in Publican Licences and Per Capita Consumption of Alcohol (1965-1996)⁸



It is hard to argue therefore, that restricting the number of licences is an effective and proportionate manner of reducing the consumption per capita of alcohol. The Authority pointed out in its two submissions to the Liquor Licensing Commission that taxes (which ensure that the State obtains a greater proportion of the rents in the industry) are a more measured and proportionate measure to control the harmful consumption of alcohol⁹.

The quantitative restrictions on entering the pharmacy market created secondary market values for pharmacy licences of upwards of €500,000¹⁰. The recent purchase by Gehe of the Unicare group of pharmacies, which was reported to be at a price lower than had been agreed prior to the abolition of restrictions, illustrates the fact that the restrictions in

⁸ Source: World Drinks Trends, 2000. Revenue Commissioners.

⁹ The Authority's submissions to the Liquor Licensing Commission are available on the Authority's website (www.tca.ie).

¹⁰ The Retail Pharmacy Sector in Ireland, A Sector Overview. Brenson Lawlor, and the Sunday Business Post, 16 December 2001.

question had in themselves raised the cost of entry to the sector. The Authority has also outlined its opposition to other restrictions such as the *three-year rule*, whereby pharmacists who are professionally trained in other EU and EFTA countries are prevented from ever managing or supervising a pharmacy that is not more than three years old¹¹. Restrictions such as this distort people's choices both in terms of the careers they decide to go into and where they will study, and create a wedge between individual and society's valuations of career paths, which is in itself inefficient.

These examples show the negative impact that unwarranted restrictions can have on society. Too often the producer's interests have had a disproportionate impact on public policy making. As the OECD (2001, p.48) pointed out in the Report on Regulatory Reform, policy making in Ireland:

“... still confronts rent seeking attitudes, typically in the form of close relationships between elected representatives and particular producer interests which usually act against market principles”.

The Competition Authority views the current consultation process as an opportunity to turn back on this traditional imbalance and to place consumer's interests at the heart of decisions on how and when to impose regulation.

2.3.3 Economies of Scale and Scope

Regulations on service and product type can prevent firms from taking advantage of economies of scale and scope. Restrictions such as this particularly mark service industries such as professional services including accountancy, tax advice, legal advice etc. Such issues also potentially arise in the area of utilities, where it may be more efficient for single companies to sell a bundle of services to consumers, as has been seen in the UK. In relation to professional services, in the UK concerns have been raised in relation to restrictions on multi-disciplinary partnerships (MDPs). The UK Office of Fair Trading Report on Competition in the Professions (March 2001) finds that there would be advantages to the consumer, as well as to the producer, in allowing MDPs:

“...The opportunity to provide combinations of high-street professional services under one roof should unlock potential cost efficiencies and enhance customer choice and convenience at this level of the market.”

The Authority has commissioned a study to assess restrictions in the supply of professional services in Ireland, which will include, *inter alia*, a consideration of such restrictions.

In the area of supply of utilities, experience from the UK suggests that the market will support firms that specialise in the supply of electricity, gas and even basic

¹¹ Competition Authority, Submission to the Pharmacy Review Group, December 2001. This submission is available to download on the Authority's web-site (www.tca.ie).

telecommunications. These firms can exploit economies of scale and scope in terms of managing a customer list, credit control etc. Increased competition in the supply market has ensured that some proportion of these efficiencies are passed onto consumers.

2.3.4 Administrative Costs of Regulation

Regulations can impose high administrative costs on governments, firms and consumers. This is particularly so when regulation is disproportionate or is not directly linked to some public policy objective. These administrative costs of regulation are made up of:

- Direct costs to government – the cost of administering the regulatory system, including development and adjudication
- Compliance costs – e.g. administrative and paperwork costs for business and citizens, and capital and recurrent production costs, which according to the OECD (1997, p.199) fall disproportionately on small and medium sized enterprises. “Red tape” can reduce competition, innovation and investment and hence slow structural adjustment and productivity growth, and diminish consumer surplus.

The administrative burden of regulation goes back to core issues of proportionality and the discipline of Regulatory Impact Assessment. Where it can be shown that the costs of regulation are disproportionate consideration should be given to sun-setting or to move to a less burdensome regulatory alternative.

2.3.5 Technological and Product Innovation

There may in some cases be little incentive for firms enjoying significant market power to pursue technological innovations in production or to create or adapt goods and services in response to changing customer needs. For example, the OECD (1997, p.288) describes how a lack competition in the telecommunications sector in OECD countries had impeded the diffusion of technology:

“The effects of insufficient competition in impeding technology diffusion are visible in the telecommunications sector, which remains under monopoly control in many countries... Data show that use of the Internet (i.e. penetration rate for Internet hosts) is five times higher in competitive than in monopoly markets. Similarly, the diffusion rate for mobile (cellular) phones is directly related to the national regulatory regime. In monopolies, the monthly growth in subscriber per 1,000 inhabitants is less than 1%, rising to 1.7% in duopolies and to almost 3% in markets with open competition.”

Overall, it can be summarised that the direct results of inappropriate regulation in a particular sector are likely to be higher costs, higher prices, misallocation of resources, lack of product innovation and poor service quality. Beyond any particular sector, there may also be substantial negative systemic effects and distortions.

2.4 The OECD Review of Regulatory Reform in Ireland (2001)

The OECD Review of Regulatory Reform in Ireland (2001) identified a number of sectors where regulation leads to inadequate supply of, or demand for, goods or services, leading to welfare shortfalls for either consumers or producers or both. The Review contains a number of recommendations for action, which, based on international consensus on good regulatory practices, and on concrete experiences in OECD countries, is likely to lead to improvements in regulation in Ireland. The key recommendations are outlined in detail in Appendix 1.

In addition to recommendations related to specific product or service markets, the Report included a chapter on “Government capacity to assure high quality regulation.” The findings included:

- o Ireland’s regulatory governance lagged behind dynamic market and social change, and hence formed a potential bottleneck to sustained growth;
- o The “proportionality principle” (i.e. that regulations should be proportionate to the problem at hand) was insufficiently developed in government policy and the Regulatory Policy Checklist;
- o Consultation processes favoured producers over consumers and were vulnerable to ‘insiders’ or powerful interest groups, relative to consumers or market entrants;
- o Regulatory Impact Analysis (RIA) had not been implemented effectively and economic assessment of proposed rules was missing;
- o Administrative burdens and anti-competitive licensing schemes still governed activities such as utilities, public transport, banking, lotteries, places of public amusement, and professions, and were frequently used policy tools in areas such as environment and health;
- o There was a lack of co-ordination of information required by departments and agencies, which had a disproportionately high impact on small and medium-sized enterprises;
- o The judiciary, Oireachtas and new regional powers needed institutional adaptation in terms of efficiency, accountability and overall co-ordination.

Overall, the OECD in its Review acknowledged that progress had been made in building capacity to assure high quality regulation. However, more work needed to be done on consultation processes, regulatory impact analysis, reducing administrative burdens, review of regulatory processes and the modernisation of state institutions.

2.5 The need for review

Regulation is often necessary, but it also has the potential to reduce competition and raise costs. Therefore, there is a balance between the potentially positive contribution of regulation to the quality of service and protection of consumers, on the one hand, and the potentially negative effect on competition and consumer welfare on the other. Regulatory reform requires an understanding not only of the particular sector or market in question, but also of the purposes of the regulation and how reform, or indeed lack of

reform, would affect those purposes. In particular it requires an assessment and incorporation of various interests involved, including those of consumers. This may seem an obvious point, but the danger of “regulatory capture”, whereby those regulating a sector come to represent the point of view of industry rather than consumers, is well recognised in economics.

That there is high level support for reform is evidenced by the comments of An Taoiseach, who in welcoming the OECD’s Review in April 2001, indicated in his press statement that the OECD recommendations represented a basis for progress in relation to regulatory reform in Ireland:

“I am convinced of the potential to use the regulatory reforms suggested by the OECD to secure the progress we have made over the past decade in economic and social terms. Now is the time to take action, as a streamlined regulatory system can help us to sustain high future growth, to manage inflationary pressures and to deliver better economic and social policies to the people of Ireland.”¹²

In some cases, progress has already been made but much work remains to be done and, in this context, the proposed National Policy Statement on Better Regulation, which follows directly from the OECD Review, represents an opportunity for Ireland to become a leader in regulatory reform.

The major turnaround in the Irish economy in the 1990s, after many decades of underdevelopment, was not, according to the OECD (2001, p.14) significantly contributed to by Irish regulatory reform. However, this provides an opportunity for the Irish economy in that there are unrealised gains to Irish society to be achieved through regulatory reform. The OECD noted that at this stage, regulatory reform in Ireland holds out the promise of

“... helping the government to manage the negative consequences of years of exuberant economic performance and establish new ways to sustain high future growth” (OECD, 2001, p.12).

It is against this background that regulatory reform in Ireland has rightly assumed a degree of urgency.

Towards this end, the current consultation can play a useful role, particularly in encouraging identification of existing regulations that should be abolished or amended to better reflect consumer concerns. It should also encourage public administrators to prepare for the implementation of Regulatory Impact Assessments as appropriate. At the same time, the momentum for regulatory reform should not now be lost in a long period of reflection. The task is now to proceed vigorously with reform on the basis of, on the one hand, facilitation of competition in the interests of consumers and, on the other,

¹² www.irlgov.ie/taoiseach/publication/smi/rrpresstatement.htm

emphasis on ensuring that regulations – existing or new – are strictly proportional to their objective.

3 QUALITY OF GOVERNANCE

In this section of the submission, the Authority outlines its comments in response to the following issues raised in the Consultation Document

- the interaction with the legal and judicial process;
- consultation; and
- independent sectoral regulators.

3.1 Interaction with the legal and judicial process

3.1.1 Judicial review and possible alternatives

Because of the citizen's constitutional right of access to the courts, judicial review is an option at any stage of the decision-making process. There is a danger that adding other stages such as conciliation, mediation, and appeals boards after the initial decision would unduly extended the process. On the other hand, since judicial review considers only the process by which a decision is reached, such mechanisms may have a useful role to play in dealing with the substance of a decision. In order to avoid possible misuse of the judicial process to delay implementation of regulatory decisions, consideration should be given to allowing such decisions to stand while they are under appeal or review, as is the case in telecommunications.

3.1.2 Judges and competition issues

The OECD recommended that ways to develop judicial expertise in competition matters should be considered, e.g. that competition cases might be assigned to judges on the basis of their expertise in competition matters. The Authority welcomes the degree of specialisation that has occurred in the High Court in relation to this.

3.2 Consultation

In relation to possible mechanisms for the consultation of consumers, the inclusion of consumer representatives in social partnership structures, oversight boards, regulatory boards, advisory boards, etc. may be helpful where feasible. The use of consumer focus groups on specific issues may in some cases be a channel for the useful expression of consumer views. Transparency in policy making and regulation – including the electronic publication of analysis and reasoned decisions (thereby using Information Technology to tackle information deficits) – may encourage public debate and give greater prominence to consumer views.

Developing consultative mechanisms with consumers may help to redress the historical imbalance in regulation favouring producer interests. Maintaining a consumer focus is necessarily a key feature of innovative regulatory designs and alternatives to regulation.

Two such approaches are referred to in the Consultation Document, namely, self-regulation and co-regulation. Others that are in use in OECD countries [OECD, 1997, p.220] include information disclosure, economic incentives, tradable property rights, voluntary agreements, risk-based liability, persuasion and performance-based approaches.

3.3 Independent Sectoral Regulators

3.3.1 Lessons from experience elsewhere

In the UK, in July 2001 the Better Regulation Task Force (BRTF) launched its report on Economic Regulators. This examines the performance of the UK regulators and suggests improvements. The report notes that the introduction of competition and regulation into the former utility monopolies has brought tangible benefits to consumers. Notwithstanding these notable benefits, the Task Force examined some critical issues, including:

- Are the economic regulators as effective as they might be?
- Could the level of regulation be reduced?
- Do the structures and processes in place make for good regulatory practice?

The Task Force used the principles of good regulation (transparency, accountability, proportionality, consistency and targeting) to consider the regulatory frameworks for energy, telecommunications and airports. Specific areas considered were the role of government in regulation; the effect of price regulation on investment; the relationship between competition law and sectoral regulation; procedures for challenging the regulators' decisions, and the use of self-regulation.

The Task Force made the following recommendations:

- Regulators' annual business plans should include a clear explanation of how they will prioritise their different objectives. Regulators should also explain how the decisions they take relate to their objectives.
- Economic regulators should be required to produce assessments of costs and benefits for proposals with a significant impact on business activity.
- The boards of regulatory bodies should include both executive and non-executive members. They should be appointed for their expertise rather than to represent stakeholder groups.
- Regulators should include in their work plans proposals to encourage an innovative approach to consultation, allow a real dialogue between different stakeholders and demonstrate how proposals have been amended following consultation.
- Regulators should set out a programme in their annual work plans to review market sectors for lifting price controls and the removal of outdated licence conditions. Companies should be able to challenge failure to complete these programmes.

Whilst not all recommendations may be relevant to the Irish context, they are nonetheless worth considering, particularly while regulation in Ireland is still being bedded down. Of particular interest is recommendation 5, which deals with the issue of the removal of regulatory controls. This recommendation is dealt with in more detail below, in the context of some issues that have arisen or may arise in relation to the regulatory process in Ireland.

3.3.2 Regulatory Design

The steps required to foster competition in a network infrastructure industry clearly depend on the starting point. Some tasks are best performed by government at the outset (rather than, for instance, by competition authorities or sector-specific regulators as competition in the sector develops). The OECD¹³ has identified these tasks as:

- removing legal barriers to entry;
- assuring new entrants that the incumbent will operate as a commercial entity, and in particular will not benefit from having its deficits automatically and continually underwritten by the government;
- abolishing any favoured access the incumbent may enjoy to government controlled or owned scarce inputs, and ensuring that such resources will eventually be allocated to the producers who can make most efficient use of them;
- making any vertical and horizontal splits deemed advisable to help deal with situations where the incumbent owns “essential facilities” which new entrants require to compete but cannot economically duplicate;
- dealing with stranded costs and abandoning or re-structuring universal service obligations so that incumbents do not lose business to less efficient new entrants; and
- taking measures to offset artificial incumbent advantages.

If sufficient consideration is not given to such issues at the outset, the regulator will face an impossible task in attempting to introduce competition where the industry structure actually precludes it. The failure to re-structure regulated industries in advance of liberalisation, through vertical and horizontal separation, may cause a whole range of competition and regulatory issues to arise on a continual basis. The electricity sector is the clearest example where structural separation of the transmission network (with the Transmission System Operator both owning and controlling the assets) might have resulted in a more successful liberalisation process. Other initiatives, such as capping the incumbent’s generating capacity or splitting up the assets, have been successful in other jurisdictions. It is also now well accepted that liberalisation of electricity markets is problematic in jurisdictions with known capacity problems. The recent departure of major players from the Irish electricity market is likely to act as a deterrent to new entrants and reduce the likelihood of effective competition developing.

¹³ Relationship between Regulators and Competition Authorities, DAFNE/CLP(99)8, Competition Policy Roundtables No. 22, available at <http://www.oecd.org/daf/clp/Roundtables/relat00.htm>

3.3.3 *Regulatory Objectives and Regulatory Creep*

The legislation underpinning each of the regulator's offices in Ireland reveals potentially conflicting objectives – for example, maintaining low prices while ensuring adequate investment in infrastructure, or meeting emissions targets while maintaining peat-burning stations in operation. In the UK, the BRTF, as noted in Section 3.3.1, above, recommended that to reduce uncertainty and increase the consistency and predictability required by companies, regulators should make the trade-offs between their objectives explicit in their annual business plans.

It was also noted in the UK that the regulators' objectives have been broadened to include environmental and social considerations, resulting in increased costs to regulated companies. For instance, under the UK Utilities Act 2000, the energy regulator's duties are outlined as "to protect the interests of consumers ... wherever appropriate by promoting effective competition". However, the regulator must also have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas. It is not immediately clear that these objectives are best addressed within a regulator's office, rather than by other Government agencies that specialise in dealing with such issues, and by a range of other Government instruments. This tackles the problem directly, rather than through a series of potentially contradictory actions of regulators. Furthermore, such an expansion of objectives also has the potential to completely clog up the normal regulatory consultative process. Regulators would have a statutory duty to take on a considerably expanded series of issues and make reasoned decisions addressing them.

Regulatory creep of this sort should be resisted in Ireland. It is duplicative of the efforts of other Government agencies that are better equipped to deal with the issue in the first instance. It also runs contrary to the notion that regulator's offices should be scaled back once the point of effective competition is reached.

3.3.4 *Sun-setting and Exit Strategies*

If the rationale for regulation is to allow competition to develop in a sector, it follows that there is a need to remove the regulatory burdens on sectors as soon as effective competition emerges. Of course, in each sector there may remain key areas where effective competition can never be expected to emerge - for example, transmission in electricity. In such areas, continued price regulation may be the best outcome. The speed with which regulatory burdens can be removed depends on market entry, technology choice, regulatory capture and the impact on capital costs of regulatory uncertainty (and the impossibility of making credible long term policy commitments). Outside this, there is a growing resistance amongst the business community to bear the cost of regulation, particularly compliance costs. In a small economy these concerns are more pronounced due to the fixed costs of maintaining numerous regulators.

Most regulators agree that, once sufficient competition has developed in a particular market, regulatory constraints on that market should be rolled back and only general competition rules should remain to police any potential abuses. There are, however,

many barriers to regulators withdrawing from markets. It may be in the interest of less efficient players to maintain regulation so as to protect their vulnerable market position. In addition, the regulator may have a concern that the normal competitive process will result in a reduction in the number of licensed operators. Finally, it is long been recognised that any office will be reluctant to take measures that would see it at once lose influence and resources.

In the interests of all parties, it is desirable that a clear and unequivocal statement of when regulation will be rolled back be published in advance and subject to periodical independent review. Regulators should set out a programme in their annual work plans to review market sectors and, where appropriate, lift price controls or remove outdated licence conditions. In an Irish context it is clear that the Competition Authority would have little to gain from erroneously declaring a particular market sufficiently competitive to merit the withdrawal of regulation - a point that is made independently by the OECD. No argument could be made to increase resources available to the Competition Authority due to the need to do something that the Authority was already obliged to do. It would be impossible to argue on one hand that a particular market (that was previously regulated) was just like any other market, but on the other hand had some special features would mean that the Authority would require more resources to deal with it. The Competition Authority could act as an appeal body in relation to a regulator's decision in this regard. It is interesting that even though this suggestion was made by the BRTF in the UK, the UK regime (because of the concurrent powers of the OFT and the sectoral regulators to apply competition law) is the only one where a competition authority would be able to argue for more resources if it were to be solely responsible for policing competition law in a regulated market.

3.3.5 Co-operation between Competition Authority and Sectoral Regulators

A new framework for the relationship between the Competition Authority and various statutory bodies, including sectoral regulators¹⁴, is outlined in Section 34 of the Competition Act 2002, which comes into effect on 1 July 2002. This provides for "co-operation arrangements" and the exchange of information, in line with the suggestions of the OECD and the Competition and Mergers Review Group.

The list of potential matters that could be included in any such agreement is deliberately non-exhaustive. However, the definition of co-operation arrangements included in the Act includes regular consultation (especially on issues where there is a natural overlap of jurisdiction), the exchange of information and a procedure for allowing one body to cede responsibility to the other. The Authority and the scheduled bodies will be able to exchange information, with the in-built safeguard whereby any information exchanged between the Authority and a body will be treated confidentially. There is also a provision for a default agreement being imposed by the sponsoring Ministers in the event that the

¹⁴ At present, co-operation agreements are required with the Broadcasting Commission of Ireland, the Commission for Energy Regulation, the Commission for Aviation Regulation and the Director of Telecommunications Regulation. This list may be amended in due course by Ministerial Order.

Authority and the regulator cannot come to an agreement. Such an outside option will no doubt focus minds as each body attempts to control its own destiny.

Whilst it is clear that the Authority and the National Regulatory Authorities (NRAs) will sometimes have divergent opinions, a formal co-operation agreement and continual high level contact should ensure that such inevitable differences do not escalate and prevent mutually beneficial co-operation from taking place.

3.3.6 Final Regulatory Structure

When the current regulatory system matures, the question can be properly asked whether all the regulators may not be better subsumed into a single regulatory office. Where economies of scope exist in regulation, this would help reduce the long run costs of regulation, which are inevitable higher in smaller economies, and allow information and knowledge synergies between regulators to be exploited. In addition, the OECD has highlighted the impact that moving to multi-sector regulators would have on helping to curb the incentives and opportunity for regulatory capture.

It could be envisaged that the single regulatory office would ultimately deal with a core set of specific issues:

- Networks, where access is required (e.g. to the electricity grid or railway)
- Two-way access, where inter-connection fees are required (e.g. where customers buy an initial journey from one provider and then complete the journey with another provider)
- Universal service obligation, where the policy intention is to deliver a product on a universal basis (e.g. electricity, telephone or postal delivery)

While this would appear to be a worthwhile aim in the long run, there would be merit in the interim in continuing with the current policy of adding new sectors onto current regulators (post to the ODTR and gas to the CER) rather than set up new regulators' offices¹⁵. For example, the aviation regulator's office could perhaps be expanded to take on other transport issues.

3.3.7 Conclusions regarding sectoral regulation

The Competition Authority has long pointed to the importance of choice of industry structure, arguing consistently that clear structural separation of the potentially competitive elements from the monopoly ones is the optimal industry structure. This would, if adopted, have led to a much lower regulatory burden and would have allowed new entrants to enter the market without the chilling impact that a vertically integrated firm may have on the market. An important issue for the future is ensuring the minimum distortion of competition in the areas of stranded costs and universal service obligations etc. Enforcement of the Competition Act's prohibition on abuse of dominance will also be key.

¹⁵ The health insurance regulatory body is an exception to this general trend.

The relationship between the Authority and the sectoral regulators must continue to deepen and this will be fostered by co-operation under the Competition Act 2002.

Regulatory bodies should consult with interested parties on the modalities of exiting/sun-setting (in areas where the removal of regulation is feasible) once effective competition is established. The conditions under which this will be formally considered need to be made clear to market participants. There are strong arguments that there is a role for the Competition Authority in adjudicating on whether the level of competition is sufficiently effective to remove regulatory controls.

To ensure that regulation is proportionate, and removed once it is no longer required, regulatory creep should be resisted. Failure to do so may lead to an over-cumbersome regulatory process and hinder the sun-setting process.

Policy makers must soon start to consider what the structure of regulation should look like once the process of sun-setting is well established. In the long run, there may be a case for a single regulatory body, on the basis of efficiency advantages and a reduction in the incentives for regulatory capture.

4 EFFICIENCY AND EFFECTIVENESS IN THE PUBLIC SERVICE

4.1 Recent Research in Government Departments and Offices

The OECD Report (2001) identified key gaps in Ireland's institutional capacity to maintain the quality of regulation and indicated that a more "coherent and determined policy approach" was now required. In assessing the preparedness of Government Departments and Offices to proceed with regulatory reform, the findings of PA Consulting Group, in its 'Evaluation of the Strategic Management Initiative' (March 2002), are not reassuring. Among the findings of a broad survey of Departments and Offices by the PA Consulting Group (pp.51-54) are the following:

- A shared understanding does not exist across Departments/Offices on what better regulation/regulatory reform entails.
- Departments/Offices have made uneven progress on regulatory reform ranging from non-engagement with the reform agenda, to substantial achievement in some areas (notably economic reforms in removing market entry barriers, and consolidating legislation/simplifying procedures).
- With some exceptions, regulatory reform has not yet gained the necessary momentum and remains at an early stage of implementation. In all cases where significant consolidation has occurred, a critical success factor has been the alignment of the political and organisational agendas.

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- There is little evidence of progress in consolidating/reviewing secondary legislation, which has a significant impact on various sectors and individuals.
 - Departments/Offices have not produced guides to legislation, other than the explanatory memoranda integral part to the legislative process.
 - It was difficult to find evidence that the Quality Regulation Checklist was being applied to new legislation.
 - Sunset/replacement dates are not generally indicated in new legislation.
 - Departments/Offices are concerned that Regulatory Impact Assessment (RIA) will be layered upon existing ‘proofing’ requirements such as those related to equality, environment, rural development and poverty.
 - With regard to Departments/Offices that exercise licensing functions limiting market access, at least one case (taxi licences) was reviewed as a result of a court decision and, in a number of cases, barriers to entry have been removed. However, there are still outstanding examples of barriers to entry where the dismantling process has not begun (generally because it is not perceived as a priority in the context of the Department’s work programme).

All of this leads to the following conclusion by PA Consulting (p.54):

“Regulatory reform ... is at a less developed stage than other components of the modernisation agenda ... the implications of the regulatory reform agenda have not yet been fully appreciated across the civil service ... [and] in some [Departments/Offices] a sense prevails that Regulatory Reform is ‘not for them’. ... In most Departments/Offices, there is little evidence that the regulatory reform agenda has permeated through core policy and operations”.

In the light of these findings, there is a clear need for the potential gains of regulatory reform to be sold to Departments and Offices. One vehicle in this regard will be the proposed National Policy Statement, in which it would appear essential to describe the benefits of better regulation, together with the message that those benefits are increasingly being recognised internationally.

4.2 The State’s regulatory role and competition policy

The main reasons for economic regulation that are related to market failure – including information asymmetries, externalities, public goods and market power – have been outlined earlier in this submission. It would be useful to include these in the proposed Policy Statement on Better Regulation, together with an indication that any regulation in this context should be aimed at achieving a specific objective, and that it should be possible to measure whether or not the objective is being achieved. Even where the reasons for government intervention are non-economic, such as fairness and equity, the promotion of culture and the maintenance of national security, regulation should be proportionate to an explicit objective.

The following are proposed as basic principles in the making of new regulations and, importantly, the review of existing ones:

- (a) economic regulation should be based on a clearly identified market failure,
- (b) restrictions to competition should be strictly proportionate to an explicit objective, and
- (c) a consumer welfare standard should be adopted in considering whether a regulation is appropriate or whether other alternatives would be more suitable.

The point about reviewing existing regulation is an important one. The OECD (2001) has recommended that certain licensing restraints imposed by the State be removed, particularly those with quantitative limits. Licensing rules targeted to achieve legitimate, explicit objectives such as safety or necessary quality standards do not ordinarily require quantitative limitations on entry. However, there are numerous long-standing licensing schemes having the effect of preventing entry and permitting non-competitive behaviour. Since those already present in the industry tend to benefit from these restrictions, their removal is fiercely opposed. Reviewing regulations in an objective, fact-based manner can help focus the debate on the consumer, rather than the producer, interest and help to build a constituency in support of change.

A helpful guideline, based on the advice of the OECD, is to determine the purpose of a regulation, or a proposed regulation (having regard to the interests not just of the producers, but also, crucially, of consumers) and then to restrict the effect of any regulation to the stated purpose. This requires that an assessment of the effects of regulation on consumer interests be built into the analysis, so that even if consumer views are difficult to elicit (for instance, because individual consumers are dispersed and poorly organised by comparison with industry groups) their interests are still given weight. It also requires that consultative arrangements be clarified so as not to be restricted to producer interests.

4.3 Equality, Equity and Social Inclusion in Delivery of Public Services

In the protection of the broad public interest, there are cases where public service obligations (PSO) or universal service obligations (USO) are imposed. Where uniform tariffs are imposed, these obligations can lead to geographical cross-subsidies, which can result in people on lower incomes in some areas cross-subsidising wealthier people in other areas.

There are many ways of dealing with such obligations. It is worth exploring whether they can be met through the use of market mechanisms, with subsidies paid directly to those deemed to be in need of assistance, thereby contributing to transparency and avoiding unnecessary market distortions. The subsidised customers could then benefit from competition among companies seeking to serve them.

4.4 Better Analysis of the Effect of Proposed Regulations

Best practice on legislation is achieved through the following elements:

- Consultation;
- Assessing the costs and benefits of regulations in advance (Regulatory Impact Analysis);
- Simplification and Codification of existing legislation;
- Looking at Alternatives to Legislation; and
- Changing Institutional Structures to support better regulation.

4.4.1 Consultation

Consultation is an important tool in the assessment of the impact of any proposal for new legislation. It provides those who are likely to be affected with an input into the policy making process. There are three key elements in good consultation:

- (i) consultation documents need to be as transparent and concise as possible;
- (ii) it should be clear who is being consulted and what they are being asked; and
- (iii) sufficient time should be provided for responses.

The OECD (2001) states that “Consultation with consumer groups tends to come late, asking for pro forma comment on a finished product rather than help in creating it”. The UK Better Regulation Task Force (BRTF) makes a similar observation:

“If consultation is to be genuine it needs to start very early in the process of developing new proposals – before insiders make decisions on their own preferred options”.

Consultation therefore needs to be broadened, not only at national level but also in the case of local authorities, to the extent that local authorities have their own discretion in regulating. Operationally, as suggested by OECD, tools such as Regulatory Impact Analysis (RIA), and ‘notice and comments’ procedures are likely to be helpful. BRTF suggests using “... alternatives to paper-based consultations such as workshops to allow those with fewer resources to contribute. The process should lead to more targeted regulations and/or the replacement of regulatory measures by the facilitation of competition.

In the UK, the Cabinet Office has published a Code of Practice on Written Consultation.¹⁶ The Code sets standards for consultation documents issued by the government. It aims to increase the involvement of people and groups in public consultations, minimising the burden it imposes on them, and giving them a minimum period of time (twelve weeks) in which to respond. It may be appropriate to draft and implement an analogous code of practice here in Ireland, thus introducing an element of uniformity and providing assistance to government and other legislating bodies who may be new to the practice of running consultation processes.

¹⁶ www.cabinet-office.gov.uk/servicefirst/2000/consult/code/consultationCode.htm

4.4.2 Regulatory Impact Analysis

In order to improve the legislative process as much as possible, the practice of thinking about whether legislation is really necessary, or how it can be improved, needs to start at the very earliest stage, when proposals are first being made. A core component of the process should be the Regulatory Impact Analysis, which provides the factual information needed to develop a policy and make a final decision. The aim should be to create the best possible policy solutions, i.e. those with the fewest negative effects and the most positive effects. Policy-makers should consider the choices between making a very detailed law, making one that is less detailed and more objective-led, or deciding that legislation is unnecessary. The EU principles of proportionality and subsidiarity should be established as fundamental tenets.

When conducting a Regulatory Impact Analysis, use should be made of appropriate cost/benefit analysis. While it is certainly true that the quality, and hence the reliability, of such an analysis, will depend on the information available at the time, it will rarely be the case that the issues encountered will be entirely unique to the Irish context. Accordingly, there will often be a rich body of international experience, as well as theoretical research, available to the policy maker. A note of caution may be appropriate here: international experience is often misused. What has or has not worked in other countries may or may not work here. The policy-maker must always be aware that the regulatory/social/ economic environment of a particular country will affect how effective a particular measure will be. In essence, country-by-country analyses are not simple; the failure or success of a policy initiative may be attributable to subtle differences that are easily overlooked.

There is understandable concern among public servants, as outlined in the “Evaluation of the Strategic Management Initiative” cited above, that Regulatory Impact Analysis may impose a large bureaucratic burden and slow down decision-making. However, the current system of “checklists” already imposes such a burden while failing to provide a coherent framework for analysis. In the case of decisions with a large economic impact, it may be necessary to carry out a full-scale cost/benefit analysis; however, even in the case of relatively minor regulations, their quality will undoubtedly be improved if those responsible apply the principles outlined in Section 4.2, above.

4.4.3 Simplification and Codification

All legislation should be simple, transparent and easily understood. As existing legislation is added to and amended, it can become increasingly complex and difficult to follow. At this point, Simplification and Codification needs to take place. Simplification involves redrafting pieces of existing legislation to remove unnecessarily complex or burdensome requirements or bureaucratic procedures, or to make them more easily understood. Codification means bringing together a number of related but separate pieces of legislation into one. Much Irish legislation could stand to benefit from these processes. For example, there are a multitude of Acts and Statutory Instruments relating to the retail alcohol sector. The process could be facilitated by a faster legislative

procedure for simplification about which there is no dispute. This could be coupled with greater use of review clauses and sun setting of legislation.

4.4.4 Alternatives to Legislation

It is often the case that policy makers, when trying to achieve a particular end, turn immediately to legislation. Alternatives to Legislation may be quicker, cheaper, more flexible or have fewer negative effects. They can give those involved more freedom to achieve the desired effects while incurring lower costs.

Codes of practice, non-binding recommendations, self-regulation, financial inducements, education campaigns, reliance on market forces and economic instruments can all be successful alternatives to legislation. Extending their use where appropriate is to be encouraged. A recent example here in Ireland concerns the plastic bag tax – an economic instrument. This tax was introduced largely to combat the environmental threat posed by plastic bag littering. In principle, more vigorous enforcement of the littering laws would have achieved the same end, but at a much greater cost. The plastic bag tax scheme, by comparison, is cheap to administer and highly effective.

An example from Europe concerns the EU Action Plan on promoting safer use of the Internet, which has been a successful alternative to legislation – an education campaign. This involved awareness campaigns in different member states, an Awareness Day in Luxembourg in October 2001, and a Safer Internet newsletter. In the same sphere, the Internet Watch Foundation is a successful alternative to regulation in the UK. This is a self-regulation scheme for web content, with its basis in an agreement between Internet Service Providers, the Government and police.

4.4.5 Institutional Structures

Changing Institutional Structures to support better regulation is a crucial element of reform. Clear structures can ensure that Regulatory Impact Analysis is carried out routinely and effectively. A systematic and strategic overall approach to policy is obviously desirable. There are a number of possible ways of putting this into practice.

In the UK for instance, a system consisting of a central unit, the Regulatory Impact Unit (RIU), with satellite units in each Ministry, is employed. Together, these support a system of Regulatory Impact Analyses carried out by the policy makers in the Ministries themselves. On their website, the RIU's purpose is stated as¹⁷:

“The Regulatory Impact Unit (RIU) is based at the centre of Government in the Cabinet Office. Its role is to work with other government departments, agencies and regulators to help ensure that regulations are fair and effective. Regulations are needed to protect people at work, consumers and the environment, but it is important to strike the right balance so that they do not impose unnecessary burdens on businesses or stifle growth.”

¹⁷ The work of the RIU is described at www.cabinet-office.gov.uk/regulation/Role/Index.htm

Other member states have their own ways of making better regulation. Best practice can be drawn from across Europe. Having the right structures will encourage policy makers to make best use of the full range of tools for better regulation – regulatory impact assessment, consultation, alternatives to regulation, review, simplification and codification - from beginning to end of the policy-making process.

When the Regulatory Impact Assessment process, broadly outlined here, is implemented, there will be an associated learning curve, which may be steep at the outset. However, depending on how vigorously the initiative is pursued, and on the kind of supporting institutional structures set in place, Regulatory Impact Assessment will become part of the legislative and regulatory culture, with the effect that in the longer run legislation and regulation will become more effective and transparent.

In order to oversee and support the overall approach to regulatory reform, it is important that the High Level Group on Regulatory Reform continue to meet and to provide a network among Government Departments and Offices in implementing this important initiative.

5 CONCLUSION

The OECD Report provides the opportunity to build momentum for regulatory reform in Ireland. It is important that this momentum lead to changes being made by policy makers for the benefit of the consumer and society, rather than awaiting changes that emanate from court actions. This is particularly relevant in the light of the findings in the PA Consulting Group's *Evaluation of the Strategic Management Initiative*, in which it is clear that a considerable amount of work remains to be done to implement regulatory reform.

A necessary element of regulatory reform, emphasised in the OECD Report, is the removal of restrictions to competition, thereby allowing consumers and society to reap the benefits of competition in markets. In relation to sectoral regulators, it may be that in a small economy such as Ireland that synergies and cost savings could be realised by merging many regulators into a single regulatory office. This should be considered in the medium term. In the meantime the addition of responsibility for new sectors to existing regulators is a rational manner in which to proceed.

Given the benefits of competition in markets, regulations should be no more restrictive of competition than what is strictly necessary to achieve an explicit objective. Yet the OECD Review on Regulatory Reform in Ireland (2001) identified numerous cases where regulations restrict competition either unnecessarily or excessively. This adversely affects the welfare of consumers and society, and impairs the productivity and competitiveness of the economy. In the proposed Policy Statement on Better Regulation, the following principles should be adopted:

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- (a) economic regulation should be based on a clearly identified market failure,
 - (b) restrictions to competition should be strictly proportionate to an explicit objective, and
 - (c) a consumer welfare standard should be adopted in considering whether a regulation is appropriate or whether other alternatives would be more suitable.

The proposed Policy Statement will be a potentially valuable guide to policy makers and stakeholders. In addressing the importance of competition in markets, it will reflect the interests of consumers and the overall economy and will also reflect the expressed views of the Taoiseach and Government ministers. On its own, however, it cannot be expected to act as a panacea in view of the evidence of lack of preparedness in Government Departments and Offices to proceed with regulatory reform. In the circumstances, there is a continuing and vital role for the High Level Group on Regulatory Reform. That role is to oversee the implementation of the proposed Policy Statement on Better Regulation and to ensure that the urgent task of regulatory reform in Ireland is carried out for the benefit of Irish society as a whole.

APPENDIX 1 – OECD REGULATORY REFORM IN IRELAND

RECOMMENDATIONS

- *Remove licensing constraints on free entry, particularly those with quantitative limits.* The challenge is to identify and eliminate regulatory programmes and licensing schemes that have the effect of preventing entry and permitting non-competitive behaviour.
- *Eliminate special-interest rules that inhibit efficient competition, such as the Groceries Order.* The potentially anti-competitive effects of the Groceries Order are well recognised.
- *Strengthen implementation of the regulatory reform policy by creating stronger disciplines and performance assessment of regulatory quality within the departments and agencies, and by enforcing the disciplines through a high level committee.* Current mechanisms to implement the regulatory reform policy are too weak to change long-established habits and culture, to protect the regulatory system from pressures from special interests, to offset perverse incentives within the ministries and agencies, and to co-ordinate the difficult agenda of regulatory reform.
- *Strengthen the accountability of sectoral regulators by building capacities for appropriate overview by Parliamentary committees, and clarify the roles of sectoral regulators and the Competition Authority to ensure a uniform competition policy in the regulated sectors.* Market-oriented institutions have developed along with liberalisation of several sectors. However, the powers, nature, and accountability mechanisms of sectoral regulators are challenging the general public governance and institutional balance. Ireland was one of the first countries to start addressing the complex issues of accountability raised by this situation, and this progress should be maintained.
- *Strengthen disciplines on regulatory quality in the departments by i) reinforcing the central review unit; ii) refining tools for regulatory impact analysis, iii) adopting an explicit benefit-cost principle, iv) increasing the assessment of alternatives to regulation, v) integrating these tools into public consultation processes and vi) training public servants in how to use them.* The Regulatory Quality Checklist that accompanies memoranda for a proposed law is a crucial step forward. However, important weaknesses and gaps exist in the Irish process for regulatory quality controls.
- *Increase transparency by standardising public consultation and more use of the Internet.* Consideration should be given to establishing a 'notice and comment' mandatory requirement for all regulatory proposals, and to establishing minimum criteria and disciplines for the public consultation required by the Reduce Red Tape action plan.
- *Enhance the current programme of restating and consolidating existing laws and regulations with a target review programme based on pro-competition and regulatory high-quality criteria.* The 1995 OECD regulatory quality checklist could be used to verify the continued necessity and appropriateness of the existing stock of regulations.

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- *Expand competition in the provision of public services at local authority levels. An effective means would be competitive tendering of public services, within the framework of quality standards and monitoring.* The large role of Irish local governments in providing public services has a significant impact on the economy because the level of efficiency in public services helps determine overall price levels. Improving the quality and cost of services will require more contracting out and more intense competition.
 - *Strengthen the application of competition policy economy-wide through a series of reforms.* Vigorous enforcement of competition policy in the self-regulated professions is a priority, and advocacy by the competition authority throughout the public administration would strengthen attention to market principles. The merger process should be streamlined and responsibility for competition policy reviews for all mergers clearly assigned to the Authority. A leniency programme should be implemented to help attack cartels. Judicial expertise needs attention. The Authority should be more independent on budget and staffing.
 - *Encourage better regulatory practices at regional and local levels of government.* Safeguarding the gains made at the national level through regulatory reform will require intensive efforts to promote regulatory quality at sub-national levels.
 - *Continue to encourage the use of international standards in national standardisation activities and to promote international harmonisation in European and international fora.* Strong commitment to an efficient and reliable standardisation system not only enhances market opportunities for Irish firms but also contributes to worldwide consolidation of efficient and transparent markets for industry and consumers.
 - *Continue to work to develop regional and island-wide regulatory solutions where those improve efficiency.* Optimal regulatory frameworks for Ireland might in some cases extend beyond Irish borders into Northern Ireland and Britain.
 - *In the pharmacy sector, eliminate the restriction on economic freedom of pharmacists educated in other EU countries, and location restrictions on pharmacies.*
 - *In legal services, move the control of education and entry of legal professionals from the self-governing bodies, but maintain close ties as regards quality of entrants and content of education and training, and maintain the freedom of solicitors to advertise their fees and areas of specialisation.*
 - *Complete the process of introducing competition, and the application of general competition policy, in traditional monopoly sectors, including electricity.* A series of steps would boost market performance in the energy sector. While retaining regulatory responsibility for electricity tariffs, specific license conditions and transmission access, the Commission for Electricity Regulation should also take responsibility for regulating transmission access for gas. Enforcement of the competition law in these sectors should remain with the Competition Authority. Tariff structures should be modified to improve efficiency in the energy sector by making regulated tariffs cost-reflective. Barriers to entry for gas importers and sellers should be reduced by ownership separation of transmission from

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- potentially competitive activities. Eliminating the subsidies for peat should increase efficiency.
- *In the telecommunications sector, take a number of steps to complete the regulatory framework.* These include streamlining the licensing regime using general authorisations, rather than individual licensing, establishing concrete procedures with standard time frame for handling consumer complaints, accelerating the introduction of appropriate rights of way legislation to facilitate the construction of new networks on public highways, eliminating the “in platform exclusivity” granted to cable operators after the five-year period has expired in April 2004, using an agreed method to determine the costs of providing universal service, and developing explicit and concrete provisions governing forbearance and withdrawal from sector specific regulation.