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Regulatory Systems, Institutions and Practices

Regulation is a fact of life. It affects the food we eat, the safety of our workplace, the goods and services we buy and sell and the quality of our natural environment. It plays an important role in guarding New Zealanders from harm, protecting our rights, and ensuring that markets work fairly and efficiently. However, when regulation is badly designed or implemented it can fail to provide these protections, or place unnecessary burdens on personal freedoms and business efficiency. So is the New Zealand regulatory system as good as it should be, and how could it be improved?

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In 2013 the government asked the New Zealand Productivity Commission to develop guidance for improving the design of new regulatory regimes and recommend system-wide improvements to the operation of existing regimes. That report has recently been published¹. The origin of the inquiry was concern about a number of high-profile regulatory failures, the proliferation and complexity of the regulatory system where solutions to failure add ever more layers of regulation, the fragmentation and lack of coherence across the whole regulatory system, and the difficulty of regulatory architects to judge, *ex ante*, the impact and effects of particular design settings.

The interest in regulation in New Zealand also stems from a number of important developments:

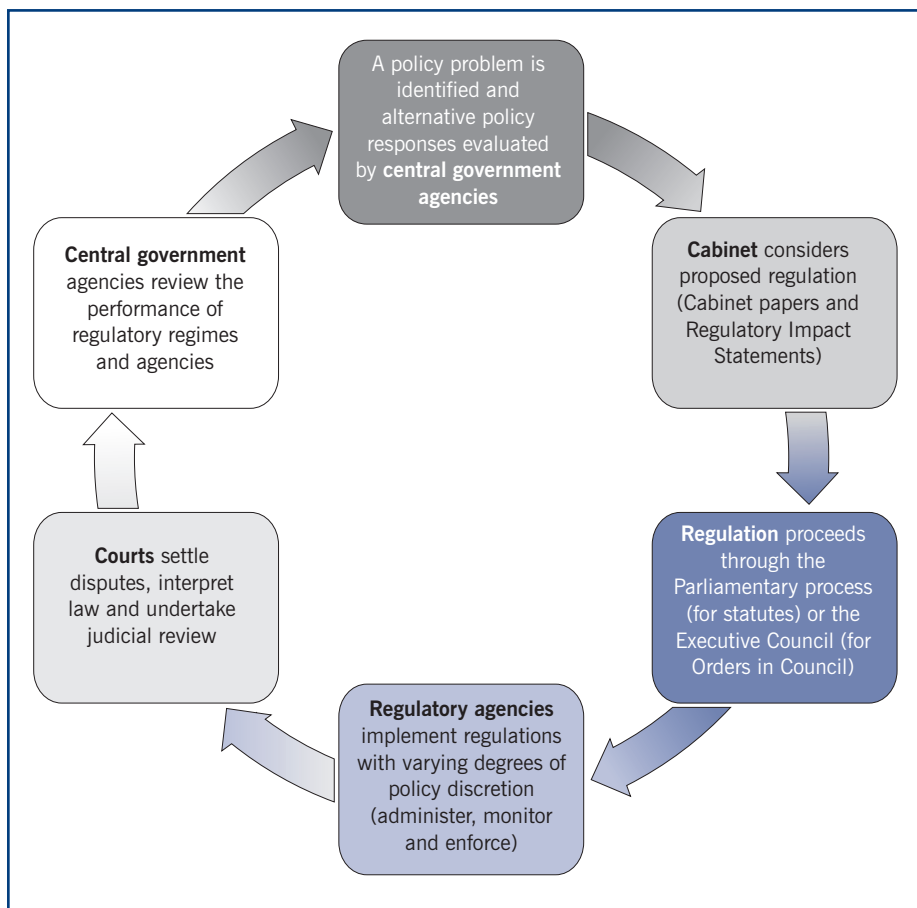
- Reforms over the last quarter of the 20th century have changed how governments organise themselves, provide services and deliver policy. A range of decisions once taken centrally by a minister or within a public service department are now taken by state providers, private firms and individuals. But governments have retained (in some cases setting rules or standards through regulation) their ability to affect the quantity, quality, safety and distribution of services. These changes have made regulation a more visible and important government activity (Yeung, 2010; Majone, 1994).
- There has been a growing awareness of the role that good-quality regulation and institutions can play in promoting economic growth (Nicoletti and Scarpetta, 2003; Crafts, 2006; Conway et al., 2006).
- Society has become much more diverse, with a broader range of attitudes to risk and expectations about what government can and should do.
- Individual freedoms and human rights have taken on greater importance in New Zealand society, as signalled by the passing of the Bill of Rights Act in 1990 and the Human Rights Act in 1993.

New Zealand's regulatory system

The 'regulatory system' is the institutions, principles and processes through which regulations are made, implemented, enforced and reviewed. It involves all three arms of government: the executive, Parliament and the judiciary. Together these shape the incentives faced by regulators and those regulated and their behaviour, and ultimately determine the success of regulation.

New Zealand has a large and complex regulatory system, with as many as 200 different regimes, a large number of regulatory agencies, and more than 10,000 people employed in administering regulation. It is a major piece of government infrastructure,

Figure 1: The regulatory system



and is as significant as the tax and spending systems in terms of its impact on the lives of New Zealanders. Figure 1 provides a stylised representation of the New Zealand regulatory system. The focus of our inquiry was on public sector organisations which have regulatory responsibilities.

What was our evidence?

Our year-long inquiry covered much ground. We received 104 submissions from a wide range of interested parties. We also held over 100 engagement meetings with individuals and groups and surveyed 1,500 regulated businesses, surveyed 23 chief executives of regulatory institutions, and undertook 13 structured interviews with members of the boards of regulatory institutions and their departmental monitors. The commission was also able to make use of a large survey (over 15,000 respondents) undertaken for the Public Service Association (PSA) of their public sector union members by Victoria University of Wellington. Four hundred and forty respondents worked in regulatory roles, in either central or local

government (300 and 140 respondents respectively).

We undertook four case studies – the regulatory settings around financial markets, the provision of aged care, and the regulatory operations of the Environmental Protection Authority and the Ministry for Primary Industries – to achieve an in-depth understanding of the challenges of implementing particular regimes. We received reaction and feedback from inquiry participants to our draft findings and recommendations through release of a draft report.

Together the evidence gathered provided a rich picture of New Zealand's regulatory landscape. We also reviewed 18 official reports of major disasters in New Zealand and overseas – from leaky buildings to mining tragedies, to the mis-selling of financial products. The failure of regulation was a central theme identified in all the reports.² We were able to extract insights into the specific institutional and practice factors that contributed to the failure of regulation and what needed to be present and working well to be effective and achieve regulatory objectives.

How did New Zealand's regulatory system perform?

A number of strong themes emerged, which confirms that New Zealand's regulatory system is not performing as well as it could be.

Quality checks are under strain

New Zealand has a number of institutions and processes to test whether a new regulation is needed, its potential impact and whether it is well designed. However, many of these checks are under-resourced or are not having the impact they should.

Parliament's Regulations Review Committee, which reviews regulations and can recommend their cancellation,

in 2013 were 'materially deficient' (Legislation Advisory Committee, 2012). Moreover, the Law Commission has had to curtail its review activities, citing declining funding. The submission to our inquiry from Parliament's legal drafters attributed much of the quality problem to the speed of the policy and legislative process.

There are also questions about the quality of regulatory policy analysis. Even after 16 years of experience, our process of regulatory impact analysis is not as robust as it could be. Analysis of the merits of regulatory interventions versus alternative policy responses is too often weak, as are the assessments of

costs on both the regulator and the regulated parties.

A key reason for this lack of flexibility is New Zealand's heavy reliance on primary legislation (acts of Parliament). New Zealand appears to produce more laws than countries such as the United Kingdom, and puts more detailed material in statutes.³ This approach generates severe capacity constraints. Parliamentary time is scarce, which means that it can be hard to update legislation to meet changing circumstances or for fixing flaws.⁴ Maritime New Zealand submitted to our inquiry that even the ability to make fundamental shifts in regulatory regimes is hampered by more urgent matters on the political and social landscape. Changes to existing regulatory regimes are generally only made in response to a significant event or crisis. And then, it is done in haste.

In other countries legislatures delegate more rule-making powers, allowing faster responses to emerging issues. There is scope in New Zealand to delegate more rule-making powers, provided these powers are appropriately defined and controlled. This proviso highlights the difficulty in making changes to regulatory regimes to improve their effectiveness and performance. The critical elements of the regulatory system are self-reinforcing and display a level of interdependency. This means that a problem in one part of the system cannot be solved simply by making a single change. For example, delegating more regulation-making authority to regulators, especially where the rules are technical in nature, or allowing regulators to amend rules to improve workability would relieve the parliamentary bottleneck, but there is a reluctance to do so because of other features or weaknesses in New Zealand's regulatory system. A number of submissions to the inquiry expressed the view that while delegating more to the Executive Council might be desirable, delegating regulation-making authority to regulatory Crown entities lacked the necessary checks and balances. The Parliamentary Counsel Office agreed that there is scope for greater delegation of authority to regulators, subject to controls, but it also noted risks, including

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has seen its membership drop over the past 15 years and needs more staff. The committee meets for one hour per week, when the House is in session. It has little more than one dedicated policy researcher to support it and its membership has declined in recent years from eight to five MPs. It operates with perfectly adequate guidelines and criteria for assessing the merits of new or existing regulation, but struggles to ensure that those guidelines are applied in practice.

There have also been longstanding concerns about the quality of law-making in New Zealand. The Law Commission told the incoming minister of justice in 2008 that legislative proposals receive inadequate scrutiny before they are introduced into Parliament, and that the mechanisms for scrutiny that do exist are fragmented. Of the 42 bills reviewed by the Law Commission in 2012, 20 did not comply with its guidelines, and the Law Commission told us that approximately half of the 46 bills they had reviewed

the efficiency and costs associated with regulation. External independent review of regulatory impact statements revealed that only a small proportion actually meet adequate quality standards for regulatory impact analysis (NZIER, 2010; Castalia, 2012, 2013).

These essential quality checks need to be revitalised. Regulators cannot deliver better regulation than their legislative frameworks allow.

New Zealand regulation struggles to keep up with change ...

Regulation in New Zealand can easily become obsolete and fail to keep up with technology or public expectations. Worryingly, almost two thirds of regulator chief executives surveyed by the commission reported that agencies often work with legislation that is outdated or not fit-for-purpose. As a result, regulators can be hamstrung, unable to respond to emerging problems or relying on 'work arounds' which can impose unnecessary

the proliferation of subordinate legislation as a result of poor regime design.

Weak feedback mechanisms can also hamper responsiveness to a changing regulatory environment. Several survey results provided perceptions about New Zealand regulators' attentiveness to their performance, and their ability to learn from experience. Our survey of 1,500 New Zealand businesses found that only 15% of businesses perceived that regulators 'always' or 'mostly' review their performance and seek opportunities to improve, although 48% thought that this happened 'sometimes'. A second but more equivocal source of evidence came from our survey of 23 regulator chief executives. The chief executives were fairly evenly split on whether they agreed with the statement that 'there are effective feedback loops between frontline regulatory staff and policy functions', which is one important avenue for identifying opportunities to improve over time. Six respondents agreed or strongly agreed that there were effective feedback loops, but seven respondents disagreed or strongly disagreed (eight respondents neither agreed nor disagreed and two did not know).

The most detailed source of evidence came from the survey of PSA members. Respondents were asked how they perceive 'their organisation's ability to learn from their mistakes and successes'. There was general disagreement among PSA members that their organisations are good at learning from their mistakes and successes, but, notably, central government regulatory staff showed the highest level of disagreement. This was significantly different compared to the responses of regulatory staff working in local government and district health boards, and to the responses of non-regulatory staff.

A resistance to sharing experiences and thus learning from mistakes and successes may be the result of negative experiences in the past, where raising issues has negatively affected the 'success' of a group. The Ministry of Business, Innovation and Employment submitted that the official response to issues or risks being raised has resulted in a cultural tendency to work around systemic issues rather than addressing them. They observed

that this tendency was a key component of the regulatory failures that it (and its predecessor agencies) were responsible for. The ministry questioned whether barriers to raising issues and risks existed just within regulatory organisations or extended across the public service more generally; however, our inquiry found that the picture is not uniform. For example, a review of the New Zealand Customs Service undertaken in 2012 noted positively its learning culture (SSC, Treasury and DPMC, 2012).

The PSA survey reveals that few central government regulatory workers believe that the management systems in their organisations are flexible enough to allow them to respond quickly to changes

since the mid-1990s. Keeping the stock of regulation up to date is an important task of the government. This means ensuring that outcomes are still being achieved, unnecessary and inefficient rules are weeded out, and needed rules are adapted to new economic and social conditions.

New Zealand does not have strong processes for reviewing its regulatory regimes and this has been recognised as a longstanding gap in New Zealand's state sector arrangements for some time. New Zealand tends to have a 'set and forget' approach to its regulation and legislative frameworks. Although there have been improvements in regulatory management systems, departments still do not, in general, systematically apply

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or evolve rapidly in response to shifts in priorities. However, while the PSA survey presents a picture of inflexibility and a lack of speed among central government regulators in responding to changes in priorities, there is some evidence that regulators are attentive to and scan for changes in risks in the regulated environment. For example, the Reserve Bank of New Zealand publishes a six-monthly Financial Stability Report which includes a systemic risk assessment. The Ministry for Primary Industries monitors changes to New Zealand's biosecurity risks.

Regime evaluation: taking a more systematic approach

New Zealand has a large and growing stock of regulation. On average, 100–150 acts and about 350 legislative instruments have been passed each year

basic good management principles and practices to the regulatory regimes that they administer (Offices of the Ministers of Finance and Regulatory Reform, 2013a, 2013b; Law Commission, 2008). Government initiatives aimed at improving the review and evaluation of regulatory regimes have struggled to gain traction in the face of other priorities and limited follow-up from central agencies. Across a number of our inquiries we have found weak capability for, and limited attention to, evaluation. There is little to guide post-implementation review and determine what would actually constitute success, and whether a particular regime is achieving this.

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ensure that the regimes they administer are relevant, effective and necessary.

More attention should be paid to improving regulatory skills ...

Effective regulation depends on skilled and capable staff. As regulatory regimes have become more sophisticated, the demands on regulatory staff have risen. When we asked chief executives of New Zealand's regulatory agencies about the capability of their workforce, around 20% thought that regulators faced significant skill gaps among their staff. The PSA survey and our survey of business give a different picture, with a more widespread perception of inadequacies in skills and training.

are guided by a common code of professional conduct; and

- share a 'professional language' and culture that instils a sense of 'belonging to the regulatory profession'.

To meet the capability challenges facing regulatory agencies requires a purposeful, structured and integrated approach to professionalising New Zealand's regulatory workforce. There are a number of initiatives already under way to promote a national framework of compliance qualifications and professional networks. For example, the New Zealand Qualifications Authority has approved the development of five

poor planning, and patchy induction for new board members.

The Treasury and the State Services Commission play a significant role in appointments to departments and state-owned enterprises. Departments should draw on this central experience and expertise in making appointments to regulator boards. Better-run appointment processes, which properly assess and fill skills gaps on boards, will deliver better candidates and better regulator performance.

High-quality leadership is also important for developing the cultures within agencies that support effective regulation, in particular the ability of agencies to learn from their earlier mistakes and successes. Some New Zealand regulators need to work harder at building these cultures. Evidence collected through this inquiry highlighted poor internal communication within some agencies, with workers feeling unable to challenge poor practices or not hearing a clear organisational mission from their senior managers. Previous restructuring of regulatory organisations has also been disruptive, with insufficient attention paid to the cultural impacts of change or the smooth operation of regulatory functions.

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Regulatory agencies face challenges in attracting, training and retaining key staff to meet these challenges.

Delivering better and more consistent regulatory services will require a more professionalised workforce, with training and qualifications that recognise common skill sets and clearer career paths across agencies. Professionalisation involves creating a workforce where staff:

- possess a core set of theoretical, practical and contextual knowledge;
- are recognised and respected by others in the profession and by the broader community for the knowledge they hold;
- have opportunities to meet, network with and learn from others undertaking similar tasks;
- are continually challenged to stay up to date with the latest developments in their field;
- share a world view about the role and purpose of their profession and

new qualifications designed to support the capability development needs of regulatory staff in local and central government organisations.

The Treasury and the State Services Commission need to provide greater support, to ensure that efforts to professionalise the workforce take root across the whole system.

... including at the very top of regulatory organisations

Much of New Zealand's regulatory activity is carried out through Crown agencies, at arm's length from ministers. Highly capable boards with the right mix of skills are important for the performance of these bodies, and of regulatory regimes. It is the responsibility of policy departments to identify suitable candidates for appointment to regulator boards. However, we found that departmental appointment processes were highly variable, including inadequate assessments of the skill needs of boards,

Monitoring of regulators is missing the mark
Crown agencies are subject to monitoring by an overseeing government department. Crown agencies also typically have an external board for governance purposes, and some have statutory independence from ministerial involvement in their regulatory functions. Under state sector legislation, the boards of regulators are accountable to ministers for their performance.

Our inquiry found a high level of dissatisfaction among regulator board members with the monitoring function. Few felt that the monitoring effort of the lead department was adding value either for the minister, who is the intended beneficiary of the monitor's work, or to the Crown agency itself. This dissatisfaction is compounded by a considerable amount of role confusion with respect to ministers, monitors, board chairs and chief executives. Too often

boards and their chairs are disempowered by the monitoring and ministers reach over boards to work directly with the chief executive of the agency concerned.

A larger question is how well placed policy departments are to assess the effectiveness of a regulator's practices and strategies: that is, whether they have chosen the best compliance tools and policies. The inquiry heard from a number of parties that the best judges of regulatory practice are other regulators. We found these arguments persuasive and recommended that a system of peer reviews be established, where panels of senior regulatory leaders – such as current and former chief executives – would examine and provide feedback to regulators on their strategies. These peer reviews would be embedded within the existing Performance Improvement Framework audits run by the State Services Commission.

The regulatory system needs clearer leadership, and a more active centre

The inquiry found weaknesses in the institutions responsible for oversight and management of the regulatory system. There is no overarching government strategy for regulation, no clear programme for its improvement, and no clear 'owner' of the system. When we look across New Zealand's public policy machinery, we find a few well-run systems with clear, coherent and functional governance supported by strong policy capability. For example, our tax system is run and owned by the Inland Revenue Department. Treasury owns and is responsible for the fiscal system, while monetary policy is the responsibility of the Reserve Bank of New Zealand. In each case the agencies concerned are clear about their role and are equipped to do the job. They are capable of thinking strategically about what they do, why they do it, how they judge success or failure and what they need to do to prepare for a different future.

In contrast, no one has clear responsibility for our regulatory system. The regulatory system is large and distributed across several departments, agencies and ministerial portfolios. This devolved model generally makes sense. Individual departments and agencies have

the knowledge needed to run specific regimes. But if the model is to work at its best there needs to be greater oversight and direction from the centre. Getting better performance from the regulatory system will require stronger leadership from ministers and central agencies, in particular the Treasury.

What was clear to us is that ministerial leadership of the regulatory system needs to be strengthened. The responsibilities of the minister responsible for regulatory management could be clarified and expanded to include:

- defining the overall objective of the system and bringing focus and attention to it;
- strategic prioritisation of effort across the system;

- specifying and allocating tasks for improving the system; and
- promoting continuous improvement in regulatory design and practice.

This needs to be properly designed and resourced, with appropriate political, institutional, managerial and intellectual support. Our inquiry report makes recommendations on how to achieve this.

A learning and adaptive regulatory system

Black (2014) describes the regulatory task as follows:

Regulation is a problem-based activity: 'society' in some form decides there is a problem, or that there is a risk of a problem in the future, and policy makers and regulators devise ways to address

that problem. But how we identify something as a problem is contingent on what we value (and therefore what we think is under threat), and how we analyse problems and create solutions for them is contingent on our knowledge and understanding of the world and our ideas of how it operates. (p.9)

Designing and implementing regulation, therefore, is extremely difficult. It is fraught with complexity, severe knowledge gaps, unintended consequences, speculation about the efficacy of different regulatory arrangements, and a regulatory environment which is in a state of constant change.

Given this reality, we cannot afford

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to have a regulatory system that is poorly equipped to respond to implementation challenges, changes in the regulatory environment, or other performance issues. Yet it appears that institutional constraints within our regulatory system have rendered it virtually incapable of gradual evolution and incremental change. How can we develop a 'learning' regulatory system – one where regulatory regimes can adapt to meet future challenges without a major event like a regulatory failure or crisis as the catalyst for necessary change? How can we create regulatory regimes that are flexible and adaptive so that they don't suffer from a slower but more insidious fate, with regulators and regulated parties doing 'work arounds' to get around outmoded or outdated requirements or design flaws?

Streeck and Thelen (2005) suggest that we need to start by recognising and accepting the gap between design and practical implementation. An acknowledgement that regulation can never be designed with perfect foresight of the consequences allows us to accept that ambiguity is inherent and the ability to change must be built into regulatory regimes. It implies that we can place less emphasis on designing regulation (and the desirability of locking the details into primary legislation) and put more emphasis on monitoring, evaluation and feedback processes that identify priorities for readjustment. Rule designers and implementers can then see themselves in an ongoing/cyclic relationship that has as its goal effective regulation. The 'set and forget' tendency of regime designers would be replaced by more ownership of and responsibility for the continuous improvement of regulatory regimes.

This does not require modification to the structure of the regulatory system, but rather the adoption of a systems approach to how the regulatory

system is managed. Much of the focus of regulatory management in New Zealand, and in other parts of the world, has focused at the front end, on the quality of regulation-making. A systems approach to regulatory management would see monitoring and review of regimes not as the end of a process – or worse, forgotten about entirely – but as a fundamental part of enhancing the quality and impact of the regulatory system. As Streeck and Thelen observe, the lessons from hindsight are perhaps more important for design than foresight. Regime review needs to have a strong link with, and input into, the ongoing design process. In many cases, however, we have found that these processes are not well integrated. Regulatory management is often fragmented and concerned with the constituent parts of the system – regime design, implementation and review individually – and not on how these parts work together and reinforce the system. A systems approach to regulatory management recognises that making a change in one part of the system may

require changes to other parts to be made.

The inquiry's recommendations for improvement in New Zealand's regulatory system might appear daunting. However, the challenges are vastly outweighed by the costs of not making the effort. The stakes are high. A poorly-performing regulatory system is a significant drag on New Zealand's economy and society; there are heightened risks of regulatory failure; and, ultimately, there is a risk that society's trust in the integrity of the New Zealand regulatory system will be severely compromised.

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- 1 While this article draws on the Productivity Commission's inquiry into regulatory institutions and practices in New Zealand, the opinions expressed are those of the individual authors.
 - 2 This research was inspired by and built on the work of Professor Julia Black presented in her Sir Frank Holmes Memorial Lecture at Victoria University in April 2014 (Black, 2014).
 - 3 As a comparison, between 2009 and 2014 New Zealand created almost four times more statutes than the UK.
 - 4 New Zealand has a small Parliament (120 members) and a relatively short electoral term (three years); Parliament's rules of procedure require the House of Representatives to sit in total on about 90 days a year.