

Regulation Revisited

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It is, for me, a great honour and also a matter of some poignancy to deliver the 2008 Street Lecture, not the least because last month I retired from my Chair at the Manchester University Law School, a post which I most happily held for 21 years. Harry Street was, of course, one of my most illustrious predecessors. Although he was most renowned for his work as a mainstream public lawyer, my encounters with him were in relation to other areas. His book *Principles of the Law of Damages*,¹ an insufficiently remembered tour-de-force, was an inspiration for me. Here he displayed not only his great analytical skills but also an ability to probe deeply into the policy dimension of legal rules; and this with the aid of an accountancy and actuarial input.² Indeed, he helped to foster interdisciplinary work when, within the British legal academy, it was in its infancy. My first meeting with him was when he was a member of the Social Science Research Council Committee for Social Sciences and the Law.

Regulation in 1979

The theme I have chosen for my lecture is inevitably interdisciplinary. On March 13, 1979 I delivered my inaugural lecture as Professor of Law at the University of Newcastle-upon-Tyne.³ It was intended to display my recently acquired interest in the economic analysis of law, but it was principally concerned to criticise the serious neglect at that time of regulatory law, both in the British law schools and in legal policy-making circles. I thought it might be interesting and instructive to revisit the issue some 30 years later to identify and evaluate the developments which have since taken place.

*This is a revised version of the 24th Street Lecture, delivered at the University of Manchester on October 17, 2008.

¹ H. Street, *Principles of the Law of Damages*, (Sweet & Maxwell, 1962).

² See his trenchant criticism (*Principles of the Law of Damages* (1962), pp.243–245) of the decision in *Cullinane v British Rema Manufacturing Co Ltd* [1954] 1 Q.B. 292 CA.

³ It was published as “Economics, Liberty and the Common Law” (1980) 15 *Journal of the Society of Public Teachers of Law* (NS) 42.

To speak about “regulation” obviously requires me to provide a definition of a concept which has different meanings both for lawyers and non-lawyers.⁴ Without entering into niceties, I take it to refer to obligations imposed by public law designed to induce individuals and firms to outcomes which they would not voluntarily reach. Regulation is largely enforced by public officials and compliance is aided by the threat or imposition of some sanction. As such, regulation covers a vast array of state controls over industrial and commercial activities.

Now, the criticism in my 1979 inaugural lecture was not that these areas of law had been ignored. There was legal expertise within the individual government departments responsible for the specific regulatory regimes and often a consultative autonomous or semi-autonomous agency, such as the Health and Safety Commission and the standing Royal Commission on Environmental Protection. But there was no public body with over-arching responsibility for addressing regulatory issues more generally.

Then, as regards academic legal work, there was plenty of legal analysis published on specific regulatory sectors such as health and safety at work, consumer and environmental protection, town and country planning, banking and insurance. But these writings were predominantly technical expositions of the law with little attempt to stand back from the details and critically explore the regulatory objectives and the different legal instruments capable of achieving those objectives. There were even fewer attempts to address these issues across different regulatory sectors.

Some exceptions to this general picture are worth mentioning. In the first half of the 20th century Ernst Freund made some path-breaking, but now largely forgotten, attempts to generalise about regulatory law in the United States.⁵ This side of the Atlantic, the nearest equivalent was a collection of essays written by a group of scholars (including Jennings, Laski and Robson) at the London School of Economics and published in 1935 under the unpromising title, *A Century of Municipal Progress*.⁶ In the post-war period, the most striking contribution was Wolfgang Friedmann’s *Law in a Changing Society*⁷ which chronicled the rapid growth of public law incursions on private law, including land-use planning on private property rights; state welfare provision on family law entitlements; social insurance on tort liability; and health and safety regulation and consumer protection on contract.

What did these books have in common? They were highly insightful in their treatment of legal forms used for interventionist measures, but they did not lead to any general interest among public lawyers in the topic. Why was this? One not so trivial explanation was that the authors were in some sense external

⁴ A. Ogus, *Regulation: Legal Form and Economic Theory* (Hart, 2004), pp.1–3.

⁵ *Standards of American Legislation* (University of Chicago Press, 1917), *Administrative Powers over Persons and Property; a comparative survey* (University of Chicago Press, 1928) and *Legislative Regulation: A Study of the Ways and Means of Written Law* (Commonwealth Fund, 1932). And see O. Kraines, *The world and ideas of Ernst Freund: the search for general principles of legislation and administrative law* (University of Alabama Press, 1974).

⁶ Jennings, Laski and Robson (ed.), *A Century of Municipal Progress* (Allen & Unwin, 1935).

⁷ W. Friedmann, *Law in a Changing Society* (University of California Press, 1959).

to traditional Anglo-Saxon public law. Freund, although born in America, was educated in Germany; Wolfgang Friedmann was a German émigré; and the LSE collaborators were largely political scientists. As such, these authors were less inhibited by the public law culture of common law systems. The historical, politico-economic basis of these systems is to be located in judicially determined principles of law enshrining freedom from state intervention and, with it, the Diceyan focus on judicial review and controlling the powers of the Executive.

In civil law jurisdictions, such as France and Germany, public law had a wider ambit and state interventionist law had been more readily embraced within legal culture. Certainly it has been easier to identify regulatory law in these legal systems (*la réglementation*⁸; *die Regulierung*⁹) because within public law divergent regulatory regimes have been subsumed and studied under categories such as *le droit public de l'économie*¹⁰ and *Wirtschaftsverwaltungsrecht*,¹¹ categories of law for which there are no direct Anglo-Saxon equivalents.¹²

In short, in 1979, I felt entitled to argue that the type of legal instruments used by governments for interventionist purposes, and the characteristics which made them more or less effective in achieving desired outcomes, were neglected topics both in the British law schools and in British policy-making circles generally.

Regulation in 2008

Thirty years after my Newcastle inaugural lecture the situation has changed out of all recognition. Take first government and public policy-making. We now have a government Department for Business, Enterprise and Regulatory Reform and, within it, a unit optimistically known as the Better Regulation Executive.¹³ Within the last two years, there has been a Legislative and Regulatory Reform Act,¹⁴ a Regulatory Enforcement and Sanctions Act¹⁵ and a Statutory Code of Practice for Regulators,¹⁶ together promising some sweeping changes to institutional arrangements across the whole regulatory field. And there have been similar developments elsewhere. At Brussels, a “better regulation” strategy¹⁷ has also recently emerged, mirroring to some extent the Whitehall initiatives. For some time, “regulatory reform” has had a high profile on the agenda of the Organisation for Economic Co-operation and

⁸ C. Wiener, *Recherches sur le pouvoir réglementaire des ministres* (LGDJ, 1970).

⁹ C. Kirchner, *Regulierung durch Öffentliches Recht* (Hoffmann-Riem/Schmidt-Abmann, 1996).

¹⁰ P. Delvolvé, *Le droit public de l'économie* (Daloz, 1998).

¹¹ R. Stober, *Besonderes Wirtschaftsverwaltungsrecht* (Kohlhammer, 2007).

¹² See H. Goldschmidt, *English Law from a Foreign Standpoint* (Pitman, 1937), pp.90–92.

¹³ <http://www.berr.gov.uk/bre/> [Accessed February 22, 2009].

¹⁴ 2006 (c.51).

¹⁵ 2008 (c.13).

¹⁶ BERR, *Statutory Code of Practice for Regulators—Regulators' Compliance Code* (Better Regulation Executive, 2007).

¹⁷ European Commission, *A Second Strategic Review of Better Regulation in the European Union* COM(2008)32.

Development.¹⁸ In most industrialised countries, some form of “regulatory impact analysis” is now required as part of the law-making process.¹⁹ In Belgium it is referred to as the “Kafka Test”.²⁰ More generally, the level, quality and effectiveness of regulation is now a favourite topic of political discourse.

There has also been an astonishing transformation within the academic world generally, and within the legal academic world in particular. The number of publications devoted to regulation has become very large. A crude count of the number of books held in the University of Manchester’s John Rylands Library with the word “regulation” (as used in our sense) in the title published in the 30 years before my Newcastle lecture is 10; the number published in the 30 years after is well over 80. Research institutions and educational programmes devoted to studying regulation now abound. When I arrived at the Manchester Law School in 1987, there was almost nothing on the subject. Today we now have a Professor of Regulation, a Sustainability and Regulation Research Centre, a Regulation, Security and Justice Research Centre and five courses on systems of regulation or regulation generally currently taught at undergraduate and postgraduate levels.

Public policy developments 1979–2008

How and why has all this come about? There is no easy and succinct answer to that question; rather, we need to appreciate the accumulating impact of diverse influences and sources. I shall examine, in turn, public policy and academic developments.

I begin with a paradox: “regulation” assumed a higher profile when “deregulation” became an important policy goal. In terms of breadth and intensity of intervention in commercial and industrial activities, the 1970s are generally regarded as providing the high-water mark of regulation. Public ownership was still widespread among the energy industries, and there was an unprecedented volume of detailed regulations attempting protection against risks to health and safety, the environment, and financial distress. But it was also a period of scepticism and alleged regulatory failure. Nationalised industries were perceived to be inefficient; much protective regulation was considered to be rigid, poorly targeted and inadequately enforced.²¹

Now, although what followed in the 1980s and subsequently was often called “deregulation”,²² it is more aptly designated as a period of transformation of regulatory forms and arrangements. Many publicly owned industries, particularly the utilities, were privatised, but since—prior to the liberalisation

¹⁸ e.g. OECD, *From Red Tape to Smart Tape* (OECD, 2003).

¹⁹ C.M. Radaelli, “The Diffusion of Regulatory Impact Analysis—Best Practice or Lesson-Drawing” (2004) 43 *European Journal of Political Research* 723.

²⁰ See <http://www.kafka.be> [Accessed February 22, 2009].

²¹ C.R. Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (Harvard University Press, 1990).

²² H.-J. Chang, “The Economics and Politics of Regulation” (1997) 21 *Cambridge Journal of Economics* 703, 711–716.

of the relevant markets—these firms enjoyed monopoly power, it was essential that the price and quality of their products were regulated. That raised a host of questions since such economic regulation had hardly existed in the United Kingdom since the 19th century; and the creation of new institutions, structures and processes necessarily involved some consideration of the more general issue as to what regulatory arrangements were appropriate.²³ For example, a key question was of the degree of independence from central government which the new regulators should enjoy.

Reform of other regulatory sectors was not so dramatic, but no less important. The problem increasingly besetting health and safety and environmental regulation was that of information: in an age of fast changing technology, industry (or at least some of it) was likely to know better than government how best to control risks. That suggested that the traditional “command-and-control” form of regulation was inappropriate in certain contexts and was gradually to be replaced by forms of “co-regulation”, industry contributing to some degree to the formulation of standards, self-certification and enforcement.²⁴ Then, as part of the “new management” programme introduced into the public sector, regulatory policy-making was largely separated from regulatory administration.²⁵

A third set of reforms moved in the opposite direction. Much financial and professional regulation had, for cultural and historical reasons, been informal and left to professional associations or some other private institution. In Moran’s masterly account of the phenomenon, it is designated as “club government”.²⁶ In a modern world of democracy and accountability, the legitimacy of this approach came at last seriously to be doubted. Co-regulation proved, here also, to be a suitable compromise.

The common features of the three developments that I have been describing are that they provoked a need to reflect on the function and forms of regulation across different sectors; and that need was reinforced by a fourth catalyst: the integration of markets as regards both European and global dimensions. The problem here is immediately apparent. National regulatory systems can constitute major obstacles to trans-boundary trade. Now there is a variety of solutions to this problem, from doing nothing (and thus encouraging competition between regulatory systems), through mutual recognition, to approximation between and harmonisation of national systems.²⁷ Choice between these alternatives is dependent on a complex combination of factors, but cannot properly be made without a deep understanding of the nature and operation of regulatory processes.

²³ C. Graham and T. Prosser, *Privatising Public Enterprises: Constitutions, the State and Regulation in Comparative Perspective* (Clarendon Press, 1991).

²⁴ N. Gunningham et al., *Smart Regulation: Designing Environmental Policy* (OUP, 1999).

²⁵ J. Stewart and K. Walsh, “Change in the Management of Public Services” (2007) 70 *Public Administration* 499.

²⁶ M. Moran, *The British Regulatory State: high modernism and hyper revolution* (OUP, 2003), pp.33–34.

²⁷ D. Esty and D. Geradin (eds), *Regulatory Competition and Economic Integration: Comparative Perspectives* (OUP, 2001).

Regulatory scholarship 1979–2008

We need not here be concerned with the fascinating question as to the extent to which the policy developments I have described were influenced by, or rather themselves stimulated, academic studies. Suffice it to acknowledge that interactions have taken place in both directions; and I now need to identify and characterise the intellectual contributions.

In the late 1970s, at the time of my Newcastle lecture, legal scholarship had moved, if somewhat cautiously, into the interdisciplinary arena. Collaboration between criminal justice lawyers and sociologists in the study of criminology had existed for some time. Traditionally the focus had been on street crime, but an interest subsequently developed into what was known as “white collar crime” to address the intriguing question how the treatment of regulatory offences committed by employers, traders, professionals and others compared with that of mainstream crime.²⁸

That inquiry linked to the emerging field of “socio-legal studies”. The driver of the latter was the hypothesis that law in action was very different from law in the books, thus requiring empirical investigation. One of the first topics to be studied with this methodology was the behaviour and functioning of regulatory agencies, particularly as regards law enforcement.²⁹ Some of this research had criminological roots; another source was the perception within the ranks of public lawyers that administrative law was about much more than the judicial review of executive decision-making.³⁰ An important finding emerging from this type of research was that formal legal powers and sanctions were relatively underused, with the implication that command-and-control regulation was different from other types of coercive law, notably the mainstream criminal law.

At the time when socio-legal studies were beginning to make headway, younger legal scholars were also becoming familiar with social theories of the state. Public lawyers, in their efforts to break free from the Diceyan tradition and definition of administrative law, were, in particular, attracted by corporatist conceptions of government.³¹ Regulation was in reality not a set of commands by the legislature legitimised and constrained by conventional instruments of administrative law; rather it was seen to involve a set of processes, formal and informal, managed by collaboration between bureaucrats and major interest groups, such as industrial associations and trade unions. The problem created by such arrangements was not only that of legitimation under the rule of law; there was also the risk that the regulatory goals would be subverted by the

²⁸ W.G. Carson, “White Collar Crime and the Enforcement of Factory Legislation” (1970) 10 Brit. J. Criminol. 383.

²⁹ Carson, “White Collar Crime” (1970) 10 Brit. J. Criminol. 383; G. Richardson et al., *Policing Pollution: A Study of Regulation and Enforcement* (OUP, 1982); K. Hawkins, *Environment and Enforcement: regulation and the social definition of pollution* (OUP, 1984).

³⁰ e.g. T.C. Daintith, “Regulation by Contract: the New Prerogative” (1979) 32 C.L.P. 31.

³¹ T. Prosser, “Towards a Critical Public Law” (1982) 9 J. Law & Soc. 1.

large corporate interests.³² The solution was perceived to lie in reinvigorated processes of participation and accountability.

In the 1980s, corporatism was seen to be over-simple and, as an influence on regulatory legal scholarship, became overshadowed by systems theory. I refer to the latter with some hesitation and diffidence because of my limited knowledge of it. From this theoretical perspective, regulation is viewed as a closed sub-system, with its own set of actors, procedures, culture and, above all, language, distinct from other sub-systems, such as the law.³³ Within the system, the relationship and degree of interdependence between the actors are complex, so that control internally, and even more so externally, is intrinsically problematic. The result will often be that regulation generates unintended outcomes, because the externally formulated goals are not easily internalised into the systems and then implemented there.

Undoubtedly this theory provides a very persuasive explanation for the phenomenon of “regulatory failure” to which I have already referred. It is less obvious how it can be applied normatively, to prescribe how the problems can be overcome, thus contributing to the “better regulation” debate. Julia Black, a leading exponent of the approach, nevertheless suggests that, to counter the identified difficulties,

“ . . . regulation should be a process of coordinating, steering, influencing and balancing interaction between actors/systems, and of creating new patterns of interaction which enable social actors/systems to organise themselves, using such techniques as proceduralisation, collibration, feedback loops, redundancy, and above all countering variety with variety”.³⁴

I confess to being less than comfortable with the level of abstraction as well as complexity adopted in this guidance, but I do recognise that it can be related to the phenomena of decentralisation of regulatory institutions and co-regulation which I have identified as important developments, what contributors to this literature characterise as “reflexive” or “responsive” regulation.³⁵

Associated with this literature, but at the same time, more approachable, and undoubtedly more influential for policy-making purposes, has been the work of the leading Australian scholar John Braithwaite, and his associates.³⁶ They see regulatory processes as involving continuing interaction, even a game, between the various actors (regulators, regulatees, and sometimes also public interest groups), decisions being made by reference to the perceived costs and benefits of alternative strategies. Co-operation between the players will

³² See, in relation to occupational health and safety, M. Beck and C. Woolfson, “The regulation of health and safety in Britain: from old Labour to new Labour” (2003) 31 *Industrial Relations Journal* 35.

³³ J. Black, “Critical Reflections on Regulation” (2002) 27 *Australian Journal of Legal Philosophy* 1.

³⁴ Black, “Critical Reflections on Regulation” (2002) 27 *Australian Journal of Legal Philosophy* 1, 9.

³⁵ H. Collins, *Regulating Contracts* (OUP, 1999), pp.65–69.

³⁶ See especially I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University, 1992). His most recent book, *Regulatory Capitalism: How it Works; Ideas for Making it Work Better* (Edward Elgar, 2008), brings together different strands of his rich contributions to regulatory theory.

typically generate mutual benefits but more formal, legal responses become necessary if and when the co-operative approach fails to secure the desired outcome. So, for example, an agency, seeking to enforce a given regime, will deal with contraventions by responses of increasing severity, from a base of benign advice to an apex of prosecution and punishment, until it secures compliance—the famous “enforcement pyramid”.³⁷

The reference to “costs and benefits” provides the link to the third interdisciplinary approach to regulation, that of law and economics. However, in this country, the economic perspective on regulation was slow to develop. With a few exceptions, British economists became interested in regulation only with and after the revolution in the governance of the utilities in the 1980s.³⁸ Understandably what attracted them to the new arrangements were the problems of controlling prices and the relationship between prices and the levels of competition operating in the relevant markets. For lawyers, a valuable product of “new regulatory economics”, as it has become known, has been a deeper understanding of how the institutional arrangements influence the behaviour both of the regulated industries and of the regulators themselves, having regard, in particular, to the way in which the arrangements deal with the informational advantages possessed by the industries.³⁹ Unless curbed, the latter clearly constitute an obstacle to good public interest decision-making.

It is a matter of regret that British economists working in this field have, on the whole, brought their expertise to bear on a relatively limited number of regulatory regimes. The situation has been very different in the United States,⁴⁰ no doubt because the sub-discipline of law-and-economics has flourished there to an extent not paralleled in other countries. Indeed, law-and-economics has viewed regulation from two quite different perspectives, and with two quite different sets of normative implications. The first, associated with the so-called “public choice” branch of economics, is concerned to explain the existence and form of regulation by reference to the market for legislation. A cynical conviction that most regulation confers benefits on specific groups within society and is therefore in the private, rather than the public, interest leads to a theoretical framework in which politicians supply laws to groups of citizens, in accordance with the demand for them, the price for the transaction being some form of political support.⁴¹ From determinations of which groups can offer the highest “price” and can co-ordinate their lobbying efforts at least cost, predictions can be made as to what regulatory benefits will be secured by this means.

This analysis may have greater application to, and plausibility for, the American legislative arrangements than for our own; it also underestimates the

³⁷ Ayres and Braithwaite, *Responsive Regulation* (1992), p.35.

³⁸ From the huge literature, I would single out as being the most influential, J. Vickers and G. Yarrow, *Privatization: An Economic Analysis* (MIT Press, 1988).

³⁹ J.-J. Laffont, “The New Economics of Regulation Ten Years After” (1994) 67 *Econometrica* 507.

⁴⁰ See, e.g. the textbook by W.K. Viscusi, J.M. Vernon and J.E.D. Harrington, *Economics of Regulation and Antitrust* (MIT Press, 2000).

⁴¹ Ogus, *Regulation: Legal Form and Economic Theory* (2004), Ch.3.

degree to which laws may result from ideology or altruism.⁴² Nevertheless even in a European context it is clear that some regulation, apparently in the public interest, in fact rather serves specific private interests, and may be assumed to have been the result of trading of the kind described.⁴³ Normatively, the theory also serves to focus attention on legislative and regulatory processes and the need to ensure, through requirements of transparency and participation, that they are not subverted to manipulation by private interests. In consequence this form of economic analysis can be linked to the traditional public law approaches to regulation. But, rather like systems theory, public choice can make only a limited contribution to the design of the substantive law of regulation.

In this respect, the second economic perspective on regulation has much more to offer and this is because the methodology used directly addresses the nature and form of the interventionist instrument. Starting from the conventional micro-economic postulate that intervention is justified only where the unregulated market fails to achieve outcomes which are socially desirable, in relation to any particular area of regulation the task is to identify the market failure and then to select the method of intervention which predictably will correct that failure at least cost.⁴⁴ So, for example, in relation to hazardous activities, for the choice between controls requiring prior approval, such as licences, and those subject only to product and services standards ex post market entry a key determinant is a comparison of the social costs arising from the imperfect enforcement of ex post standards with the heavier administrative costs of a licensing system.⁴⁵ Regulatory impact analysis, which has assumed an important role in policy-making, does, or should, confront policy choices in this way. A concern to minimise information costs in relation to rule-making can help to explain and justify the shift away from “command and control” to co-regulation⁴⁶; and economic models of deterrence, with their analysis of the costs and benefits of engaging in unlawful behaviour and of providing sanctions and other disincentives, can demonstrate why, for most types of regulatory contraventions, administrative sanctions are preferable to criminal sanctions.⁴⁷

Key issues for regulatory policy-makers

In the preceding section, I attempted to show how the interdisciplinary perspectives which I have outlined have provided important insights and

⁴² D. Farber and P. Frickey, *Law and Public Choice: A Critical Introduction* (University of Chicago Press, 1991), pp.26–33.

⁴³ A. Ogus, “Legislation, the Courts and the Demand for Compensation” in R.C.O. Matthews (ed.), *Economics and Democracy* (Macmillan, 1985), pp.151–167.

⁴⁴ D. Dewees (ed.), *The Regulation of Quality: Products, Services, Workplaces and the Environment* (Butterworths, 1983).

⁴⁵ S. Shavell, “The Optimal Structure of Law Enforcement” (1993) 36 *Journal of Law and Economics* 255.

⁴⁶ A. Ogus, “Rethinking Self-Regulation” (1995) 15 *O.J.L.S.* 97.

⁴⁷ A. Ogus, “Better Regulation—Better Enforcement” in S. Weatherill (ed.), *Better Regulation* (Hart, 2007), pp.107–122.

to some degree also have made meaningful contributions to the critical evaluation of significant developments to regulation which have occurred in the last 30 years or so. These include the legitimisation of systems, particularly those traditionally subject to self-regulation, through enhanced accountability, which been an important focus of social theories. The same can be said of the phenomena of decentralisation, participation and co-regulation. Economic approaches can be related to choices between, and the better targeting of, interventionist instruments. I now turn, if too briefly, to the question of the key issues which regulatory policy-makers must now, and in the near future, address; and how regulatory scholarship might be able to assist in the task. I will, I trust, be forgiven if I focus on those areas of regulatory scholarship with which I am most familiar.⁴⁸

It seems to me to that the issue which is likely to dominate debate regarding regulation in the immediate future is the legitimate scope and degree of protection against risk. Within the media two images of regulation currently compete. On the one hand, there is a perception of regulatory failure in relation to entrepreneurial excesses and financial distress and a call for more rigorous controls, the same arguments being invoked to confront accidents (major and minor), climate change, corruption, terrorism and a host of other risks. On the other hand, industry is bemoaning the fact that the government aspirations in recent years to reduce the regulatory burden have had little effect and that the problem of “red tape” is as prevalent as ever.

I must first attempt to clarify this latter assertion, for there is an ambiguity in the language used. The expression “red tape” implies the excessive administrative burden of dealing with regulatory obligations, typically in the provision of information. Interpreted as such, the criticism is often well-founded and there is a general consensus that more could be done to simplify the burden by such measures as making regulatory information requirements less cumbersome, facilitating transactions between regulatory agencies and firms, and stocking and sharing information once received.⁴⁹

However, when the representatives of industry use the “red tape” expression they usually are referring to the wider concept of the general costs of regulatory compliance, including those of taking precautionary measures. The assertion must then be interpreted as being that those general costs are too often disproportionate to the benefits generated by the required precautionary measures. My own intuition suggests that, in relation to some risks, our expectations of what regulatory systems can do are too high and that some of the protection which has emerged is ill-targeted or comes at too great a cost. To concretise this, I shall use a simple and very local example. Although it may appear to be trivial, I hope to show that it raises very fundamental issues which regulatory scholars, as well as policy-makers, must address.

⁴⁸ And therefore not banking and financial regulation, notwithstanding the current importance of these sectors.

⁴⁹ OECD, *From Red Tape to Smart Tape* (2003), p.16.

Sensible risk regulation: a local example

Some 400 yards from where the Street lecture is given, at the junction between Oxford Road and Booth Street, Manchester, there is a set of traffic lights. There is nothing exceptional about them and how they operate is typical for the centre of Manchester and, indeed, as far as I know most other British cities. However because I passed through them frequently, both as a pedestrian and as car driver, and they are close to where I regularly pondered problems of designing regulation, I have observed how they operate and their impact on behaviour.

The pattern is as follows: first, the green light allowing vehicles to travel east and west; second, the same for those travelling north and south; and third, traffic is stopped and a green signal enables pedestrians to cross in all directions. These arrangements are authorised by the Zebra, Pelican and Puffin Pedestrian Crossings Regulations 1997,⁵⁰ and individuals—pedestrians as well as vehicle drivers—failing to comply with signals, in principle commit an offence under the Road Traffic Regulation Act 1984.⁵¹ In fact, casual observation reveals that the large majority of pedestrians do not wait for the signals in their favour but cross whenever it is safe to do so. In assessing whether this form of regulation protecting pedestrians is justified, we can impressionistically attempt to appraise the costs and benefits.

It would, of course, have been possible to have omitted the third step in the cycle which protects pedestrians, leaving it to them to determine when it is safe to cross the road, taking account particularly of the signals controlling vehicles on the relevant road, but this was not done. How was the relevant decision made? How should it have been made? A set of guidelines issued by the Department of Transport in 1995⁵² provides the probable answer to the first question. The local highways authority is expected to undertake a site survey, making estimates, most importantly, of the levels of traffic and pedestrian flow, the difficulty for the latter in crossing (having regard to any special characteristics of the local pedestrian population), the accident record at the location, and the predictable vehicle delay resulting from the pedestrian crossing being installed. There is also some encouragement to take into account representations made by residents and others from the locality.

If adhered to, these guidelines would seem to suggest rational and transparent regulatory decision-making, ensuring that the benefits of interventionist measures will predictably exceed their costs. I remain unconvinced of this. Take first benefits. The only clear direct benefit of the pedestrian protection is to those (the minority) who take advantage of it and is to be assessed by reference to the increased safety and freedom of anxiety they enjoy, compared with the situation in which no such protection is available. The guidelines

⁵⁰ SI 1997/2400.

⁵¹ s.25(5).

⁵² Local Transport Note 1/95: The Assessment of Pedestrian Crossings, available at <http://www.dft.gov.uk/pgr/roads/tpm/lnotes/ssessmentofpedestriancro4033.pdf> [Accessed February 22, 2009].

admittedly require some assessment of the difficulty to pedestrians of crossing and require some estimate of the numbers of children, visually impaired persons and those with mobility difficulties likely to use the crossing. But predictions of how the accident rate might be reduced are not encouraged and consideration is not given to the proportion of pedestrians who will in any event disregard the signals.

Let us move next to costs. An estimate must be made of likely vehicle delays and my experience of the Oxford Road-Brook Street junction suggests that these are not trivial, particularly given the congestion to which the traffic controls give rise at peak periods. However, at this point in the analysis, one's faith in a cost-benefit framework for decision-making is undermined by the comment in the guidelines that "[t]he effect of delays on vehicles must be considered but should not normally over-rule the provision of a crossing where there is a clear difficulty for pedestrians".⁵³

Another serious defect is the failure to take into account some important indirect costs. I am thinking here not only of the exasperation felt by motorists as they watch the majority of pedestrians blatantly disregard the signals, but more importantly also of the more aggressive behaviour to which that exasperation seems to give rise. I get the impression (enhanced by awareness of my own reactions when at the steering wheel) that, to minimise further delays, drivers subjected to the conditions I have described tend to rush through junctions when the lights against them are amber or have just turned red; and in general drive more aggressively. If this is right, it might not be too fanciful to hypothesise that measures taken to increase pedestrian safety might in fact reduce pedestrian safety.

It would be wrong for me to reach hard conclusions on whether the arrangements at our local junction are justified because I do not have available the requisite data. Intuitively I suspect that the costs outweigh the benefits, unless the crossing is used by a significant number of pedestrians, such as children and elderly or disabled persons, who require special protection. What concerns me more is the conviction that the framework devised for regulatory decision-making appears to be biased towards protective regulation. I would add to this that representations made by interested parties to the authorities may intensify this effect, because (I assume) local pedestrians and their representatives are more likely to communicate their views and to have those views heeded than motorists and their representatives.

Lessons for regulatory policy-makers

What helpful lessons can we learn from my little example for the benefit of regulatory policy-making? Let me start from a legal, perhaps socio-legal, perspective. As we have seen, the risk-creating behaviour in this area is the subject of legal obligations. Pedestrians, as well as vehicle-drivers, failing to obey the signals at the crossings can in theory be prosecuted for an offence

⁵³ Local Transport Note 1/95: The Assessment of Pedestrian Crossings, para.4.1.1.

under the Road Traffic Regulation Act. I can imagine that there have been many convictions of non-compliant motorists, but there is little evidence of the law being enforced against pedestrians. Indeed, I have never seen a non-compliant adult pedestrian being even reprimanded by the police.⁵⁴ Why is this? To argue that the harm resulting from non-compliance by pedestrians is not sufficiently important to justify the use of limited law-enforcement resources begs the question as to why the harm was considered sufficiently serious to justify the imposition of legal obligations in the first place. And there is the additional point, that regulatory requirements should not be imposed if it is known that a large majority will not obey them and that contraventions will invariably be tolerated by the relevant enforcement authority. Such an approach tends to bring the law in general, and the specific regulatory system in particular, into disrepute.

The socio-legal perspective reveals, then, that an understanding of behavioural responses to regulatory obligations is crucial for good regulatory design. The prohibition of smoking in public places may have been effective because the ban appears to have been internalised into social behaviour without a major enforcement effort, but the same cannot be said of legislation penalising the littering of our streets, suggesting that other regulatory policies might be preferable in this area.

An economic perspective enables us to draw out two important themes from our example. First, and most, obviously, the benefit-cost framework is indispensable for proportionate regulatory decision-making; and that should involve proper consideration of indirect costs as well as direct costs, and a realistic appraisal of benefits. We can recognise that some, perhaps all, of the variables may be difficult to quantify, but that does not undermine the value of the exercise. Even if consequences are described rather than quantified, placing them within the analytical framework should enable decision-makers to make better impressionistic decisions.

This is particularly important in a world where the media attention to accidents and their readiness retrospectively to blame public agencies for failure in relation to them creates a climate of public opinion demanding the total elimination of risks. An economic appraisal of the steps necessary to achieve this shows that the marginal costs of the additional precautions necessary to reduce still further tiny risks increase massively.⁵⁵ Moreover, the resources necessary for such precautions are then not available for other purposes generating social welfare, including the reduction of other, perhaps more serious risks.⁵⁶

Secondly, economic theory can help us in identifying the least-costly method of controlling particular hazards. Nobel Prize Laureate Ronald Coase has taught us that it is simplistic to assume that all, or even most, accidents are the result of the failings of “risk-creators”.⁵⁷ The behaviour of risk-victims is also relevant,

⁵⁴ In contrast to Germany where I have myself been reprimanded for ignoring a red pedestrian light—perhaps an indication of how seriously the Germans take *Die Regulierung*.

⁵⁵ Viscusi et al., *Economics of Regulation and Antitrust* (2000), Ch.19.

⁵⁶ C.R. Sunstein, *Laws of Fear: Beyond the Precautionary Principle* (Cambridge University Press, 2005), Ch.6.

⁵⁷ R. Coase “The Problem of Social Cost” (1960) 3 *Journal of Law and Economics* 1.

particularly if they can avoid the harm by precautions which are much less costly than those that the risk-creator must take. I fear that this lesson has not been successfully assimilated by our regulatory decision-makers and the pedestrian crossing case provides an excellent illustration: by their behaviour in disregarding signals, the great majority of pedestrians show that they are capable of avoiding the risk at, to them, a trivially low cost. In their over-zealous efforts at protection, regulators too often fail to recognise the simple precautionary measures that can be taken by, and expected of, potential victims. Regulatory intervention in relation to such risks can then take the form of information regulation, requiring risk-creators to take adequate measures to communicate information about the risk to potential victims, rather than themselves reducing the risk.⁵⁸

To this argument I would expect to hear the objection that in practice ordinary people have problems in assimilating information about many of the risks and even if these are overcome, we cannot expect them always to respond rationally to the information. Both assertions are justified and it becomes necessary to discriminate between those risks in relation to which precautionary measures by victims should and should not be expected. That is not an easy task but one which should be undertaken and to which regulatory scholarship can, I believe, make a major contribution.

The contribution can be both theoretical and empirical. At a theoretical level, scholars and policy-makers need to grapple with paternalism.⁵⁹ This concept has been neglected as a subject for study, perhaps because in an age of political correctness we are uneasy about directly articulating the notion that in a given set of circumstances the state (or politicians, or bureaucrats, or experts) know better than ordinary citizens what is good for them. Uncomfortable as we may be with it, the notion of paternalism surely provides an important explanation of large tracts of protective regulation and normatively it must be important to identify situations and circumstances where the approach is justified.

Overriding an individual's preferences on the ground that the consequences are not good for that individual requires caution since it strikes at the very heart of liberty. A limited justification can be derived from the possibility that individuals recognise that they will be subject to temptations which they will find difficult to resist, but which will impose on them long-term costs. In such circumstances, the utility of individuals is enhanced if they agree *ex ante* to submit to an external control depriving them of the temptation.⁶⁰ This reasoning can then be extended to situations where individuals can recognise *ex ante* that they may behave irrationally or make errors of judgement. The paternalist intervention may then be treated as legitimate if it involves meeting what it is assumed would have been the preferences of individuals if they had responded rationally to full information about risks.

⁵⁸ W.K. Viscusi, *Rational Risk Policy* (Clarendon Press, 1998), Ch.3.

⁵⁹ A. Ogus, "Regulatory Paternalism: When Is It Justified?" in K.J. Hopt, E. Wymeersch, H. Kanda and H. Baum (eds), *Corporate Governance in Context: Corporations, States, and Market in Europe, Japan and the United States* (OUP, 2005), pp.303–320.

⁶⁰ P. Kleinig, *Paternalism* (Manchester University Press, 1983), pp.55–67.

The empirical contribution can be to identify situations not only where information is lacking or is not in practice assimilated, but also where individuals typically respond irrationally to risks. Social psychology and behavioural economics have in recent years produced much evidence on the latter, by for example pointing to circumstances in which individuals are overly optimistic on the unlikelihood of a risk materialising.⁶¹ An important task for regulatory scholarship is to draw out of the findings implications for the extent to which we cannot expect potential victims themselves to take precautions against risks.

Conclusions

To address what I have identified as key issues for the future of risk regulation, I therefore draw out two principal generalisations. First, the need to appraise regulatory responses to risk by reference to costs and benefits remains of paramount importance. Secondly, to accomplish that appraisal task successfully we need to explore at greater depth the question of what can reasonably be expected of risk victims by way of precautions. The last requirement can, indeed, be related to a more general concern: “better regulation” has to be based on a better understanding of behavioural responses to regulation.

Such a goal has several dimensions. I have concentrated on risk-victims, and the need to differentiate between circumstances where effective precautions can and cannot be taken by them. An analogous approach can be taken to risk-creators. How do they respond to the different regulatory forms and procedures? The move away from “command-and-control” to more decentralised and co-regulatory systems implies that most risk-creators are well-informed and capable of judging how best to control risk. But are they? Risk-creators are not a homogenous group: some are large, well-endowed with information and the appropriate technology and well-managed; others are small, ill-informed, struggling to make a profit and therefore unwilling to waste resources in acquiring and processing information necessary for effective risk-management. The latter need to be told what to do. In an important study, two of my Manchester colleagues have recently suggested that in the area of waste disposal traditional “command-and-control” regulation is, for these reasons, the preferable instrument for dealing with small firms.⁶²

These reflections enable me to finish this lecture with a paradox. I have shown that in the 30 or so years since my Newcastle lecture, regulatory scholarship and regulatory policy-making have made enormous progress in addressing the key issues which transcend the boundaries between regulatory sectors. To some extent that development now needs to be reversed. The generalisations that we have reached on the effectiveness of regulatory principles and processes should now be made sensitive to differences in behavioural response as regards different actors in different regulatory environments.

⁶¹ C.R. Sunstein (ed.), *Behavioral Law and Economics* (Cambridge University Press, 2000).

⁶² D. Williamson, G. Lynch-Wood, and J. Ramsay, “Drivers of environmental behaviour in manufacturing SMEs and the implications for CSR” (2006) 67 *Journal of Business Ethics* 317.