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# Government with Consent of the Governed: The Importance of Business-Government Dialogue in Economic, Regulatory and Trade Policy

John G. Murphy,
*U.S. Chamber of Commerce*

## Article at a glance

- Countries around the world need "smart regulations" that protect health and safety without slowing economic development and job creation.
- To improve the quality of the economy, regulators should better engage with the industries they regulate.
- Transparency, stakeholder engagement, cost-benefit analysis, and the ability to appeal poor regulatory outcomes are the hallmarks of good regulation.

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**Center for International Private Enterprise**
1155 15th Street, NW | Suite 700 | Washington, DC 20005
ph: (202) 721-9200 | fax: (202) 721-9250 | www.cipe.org | cipe@cipe.org

## Introduction

Following the global financial crisis, public officials and private citizens are counting on the business community to act as the engine of job creation, rising incomes, and economic growth and development. In that context, regulators must strike the right balance in their work. This is as true in the implementation of trade agreements as it is in other areas where government regulation and private business intersect.

It is an exaggeration to say that governments should regulate with "the consent of the regulated." Yet, regulators can only truly succeed in their mission of protecting human health and safety and safeguarding the environment by engaging in a real dialogue with business. Mutual understanding is crucial and there must be some give and take.

How can regulators best engage with the industries they regulate? How can they produce "smart regulations" that protect health and safety without slowing economic development and job creation? These are the key questions that governments and businesses around the world face.

## The Stakes for Society

In 2008, the accounting firm Ernst & Young surveyed global business executives in an attempt to identify the greatest risks to their business and the global business environment. The top concern was not reaching customers, securing capital, or fending off competitive threats. It was the long arm of government regulation and the costly compliance it requires.

Too often, divergent regulatory frameworks around the world unnecessarily raise the cost of doing business, close markets to competition, choke off innovation, produce unintended consequences, and fail to achieve the desired regulatory outcome.

While multinational companies have no choice but to navigate these challenges, small and medium-sized enterprises often find it too daunting or expensive to deal with multiple regulatory frameworks. As a result, they have great difficulty growing their business beyond their home market. This is why it is crucial for regulators to devise regulations that do not shut out new entrants but rather enhance competition in the marketplace.

Often business is viewed as uniformly opposed to regulation. However, the position of the business community is usually more nuanced. In the United States, for instance, the members of the U.S. Chamber of Commerce are typically more interested in ensuring that regulations are well crafted and promote competition than in simply blocking all attempts at new regulation. In other words, U.S. business is not arguing for less regulation but for smarter regulation.

The United States has developed over the years a body of administrative law that institutionalizes best practices for regulators. The purpose of this law is to ensure regulators develop regulations that are pro-competitive, effective, and efficient.

Regulators consider their first duty to be law enforcement not business facilitation. A regulator's client is not the business community, but the public, and in this context, administrative law ensures due process for the businesses that are subject to regulation. The goal of administrative law is to foster regulation that promotes the welfare of the citizenry while accommodating wherever possible the needs of business.

In the United States, many of these best practices are embodied in the U.S. Administrative Procedure Act (APA), a law dating back to 1946 that specifies how the federal government agencies should go about creating regulations. It emerged in the context of growing size and complexity of the U.S. Government, which called for a more streamlined approach to regulation. The APA standardizes and codifies rulemaking procedures across various governmental agencies; it also outlines the rules for judicial review of agency decisions. However, the United States does not have a monopoly on these best practices. Most Organisation for Economic Co-operation and Development (OECD) countries have developed similar regulatory processes that focus on transparency, engagement with

stakeholders, cost-benefit analysis, and the ability to appeal poor regulatory outcomes.

## Transparency

Most governments support transparency in the abstract but often find difficult to put into practice. Administrative law governing regulatory promulgation must be written with transparency as a paramount concern. Transparency begins with the establishment of a central registry where all regulators are required to publish their intentions to regulate as well as final regulations. In the United States, this is the Federal Register, which was created in 1935. It was the answer to a proliferation of new agencies and regulations that made it nearly impossible for the regulated entities and the general public to stay informed and to comply. The register provided better access to proposed new rules and regulations and became the official journal documenting new rules or changes to the existing ones.

Today, the Federal Register is published daily on the Internet. It includes all proposed new rules and regulations, rules that have become final, changes to existing rules, and notices of meetings and adjudicatory proceedings. A central registry, however, is just a beginning. Transparency must be embedded throughout the regulatory drafting process.

## Engagement with Stakeholders

Designing effective and efficient regulation requires that regulators engage with stakeholders – all those who would be affected positively or negatively by a regulation – throughout the regulatory development process. Ideally, the first such engagement takes place even before regulators have decided to draft a new regulation. In this stage, regulators pose questions to stakeholders to better understand the dynamics in the market and how it is functioning.

Once better informed, officials that still see the need to issue new regulation will issue notice of their intention to regulate. In doing so, regulators should identify the specific market failure or the rationale for regulating as well as outline the direction and form the new regulation may take.

Regulators should seek comment from stakeholders at least two more times in the process in order to better understand the new regulation's impact. That is why stakeholders should have an opportunity to comment on the economic analysis used in support of the regulation. Regulators should also publish a regulation in final form, before enactment, giving stakeholders a last chance to offer comments. This helps avoid drafting errors and gives the private sector an opportunity to consider further the possible measures they must take to comply with the new rules.

While it may seem a lengthy process, the drafting of regulation should be deliberate. Rarely, if ever, has rushed regulation resulted in effective and efficient regulation. Too often, a rushed process leads to unintended consequences, solving one problem but also creating new, often more severe problems.

It is important to ensure that stakeholders have adequate time to respond in each consultation. Depending on the importance and complexity of the regulation, 30 to 90 days are typically needed. It is also important that the opportunity to comment be open to all stakeholders, including both domestic and foreign businesses, and that regulators review stakeholder comments without bias.

In terms of transparency, stakeholder comments to regulators should also be publicly available. Regulators should be required to publish a response to the comments they receive. Doing so assures stakeholders that their comments have been read and helps them understand the logic used by regulators.

## Cost-Benefit Analysis

In the quest for better regulation, the next crucial element is a rigorous process by which regulators conduct a cost-benefit analysis or impact assessment. The idea behind such an analysis is

simple: if the cost of regulation outweighs the benefits of regulation, officials should consider a different approach, or perhaps not regulate at all. In short, this approach aims to ensure that regulation is designed in the least burdensome manner feasible. Such an approach should be specifically required by law, and regulators should be held to this standard.

Cost-benefit analysis can be controversial. To some, the idea of measuring costs and benefits in dollars or pesos appears subjective, despite extensive efforts by those involved to make the process a transparent and technical discipline. The economic modeling used to gauge the costs and benefits of regulation is only as good as the inputs used. Therefore, it is important that regulators rely on high-quality data and sound science.

One of the chief criticisms of cost-benefit analysis alleges that it is "cold hearted" and ignores the importance of certain political goals. These may include the needs of disabled people, environmental safeguards, and endangered species protection. In the case of a potential new workplace safety regulation, for instance, how does one put a monetary value on the loss of a finger or a limb or, worse, a life?

The answer is it is not easy, but societies routinely put a monetary value on risk. For example, insurance actuaries do it all the time. In fact, cost-benefit analysis is an area which is constantly improving as specialized regulators learn how to better monetize difficult questions. The very attempt to tackle such difficult questions in a professional, apolitical manner is itself a best practice, even if the final monetary value determined by the regulator is not perfectly precise.

Some question the appropriateness of cost-benefit analysis, worrying cold-hearted analysts may undervalue human health or safety. However, without cost-benefit analysis, government may also tilt the other way. Consider the Bovine Spongiform Encephalitis (BSE) or "mad cow" disease outbreak in Britain in the 1980s. By 1990, the front pages of British newspapers were filled with BSE articles, forcing the question "does BSE pose a risk to human health?" British officials responded, "There is nothing to worry about." They were proven wrong.

In defense of cost-benefit analysis it is also important to note that regulation is not primary law. It is secondary law. In other words, legislators set out the political objectives that regulators must meet. For regulators, cost-benefit analysis is merely a tool, albeit an important one, for creating secondary laws that ultimately must meet the requirements set in primary law.

Given the assumptions that go into the cost-benefit analysis and the complexity of the task, it is clear why it is important that the regulatory process be transparent, that stakeholders be consulted, and that they be given the opportunity to comment.

## Appeals

Regulators are fallible and are not immune from bias. At times, transparency, engagement with stakeholders, and regulatory impact assessment may not be enough to ensure effective and efficient regulation. Consequently, the final basic element in any regulatory process should be the ability to appeal any poorly crafted regulation. In the United States, there are three primary ways in which regulations can be appealed.

The first check on regulators is within the government. In the United States, for example, the Executive Office of the President maintains a special office called the Office of Information and Regulatory Affairs (OIRA) to help coordinate regulatory policy across the government. Created by Congress in 1980, OIRA is a part of the Office of Management and Budget, which assists the President in preparing the federal budget and supervising all Executive Branch agencies. OIRA also provides a final review of significant regulations before promulgation. This applies whenever a regulation has an impact on the U.S. economy of $100 million or more.

Stakeholders may argue before OIRA that regulators have not conducted a sufficiently careful analysis of the impact the regulation will

have on the market. They may argue in favor of an alternative approach that achieves the same desired outcome, but does so in a less burdensome manner. Importantly, OIRA is largely staffed with professional career personnel, not political appointees.

Another common appeals mechanism is the ability to challenge any final regulation in court. The courts have been used to stop regulation from entering into force. Stakeholders can make any number of legal arguments relating to the regulatory process and the substance of the issue at hand. Finally, any regulation can be overturned by the U.S. Congress, although this outcome is rare.

## Conclusion

These are the hallmarks of good regulation: transparency, stakeholder engagement, cost-benefit analysis, and the ability to appeal poor outcomes. The development of regulatory best practices is an evolutionary process. Market behavior and behavioral economics represent an ever-evolving field of academic work that examines how and why certain regulatory practices emerge. The major research findings indicate that one cannot simply copy one set of regulatory rules from one country to another, because they are tied to a set of cultural, historical, and legal factors, and that regulatory practices cannot remain any more static than the marketplace. However, in many different countries good regulatory practices do share common values and approaches.

It is also vital that regulations be drafted with a degree of flexibility where possible. Good regulation establishes performance parameters and allows those being regulated to determine how best to meet those requirements. Regulators should never develop standards; instead, regulations should reference standards developed by industry.

Finally, regulators should take better account of the interaction between their regulations and those promulgated by other governments. As the Ernest & Young study pointed out, there is an unavoidable tension between the growing *global* reach of commerce and the chiefly *domestic* mandate of regulators. These tensions are exacerbated by regulators who see themselves as enforcers of the law first and facilitators of commerce second.

It is going too far to say that governments should regulate with "the consent of the regulated." Citizens entrust legislators to provide broad parameters for regulators. Yet regulators can only truly succeed in their mission of protecting citizens' interests by engaging in an open dialogue with business and other stakeholders on trade and other vital economic issues. Only through regular and open engagement can regulators craft "smart regulations" that are efficient and effective and foster competition in a marketplace that serves the public interest and balances out the needs of all stakeholders.

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*This article is based on a speech delivered by John G. Murphy during the seminar on "The Role of the Private Sector in Free Trade Agreement Implementation" organized by the Dominican Republic-Central America Free Trade Agreement Implementation Project on March 4, 2010 in Santo Domingo, Dominican Republic.*

*John G. Murphy is vice president of International Affairs at the U.S. Chamber of Commerce. He is responsible for representing the Chamber before the administration, Congress, and foreign officials as he directs advocacy efforts to open international markets for U.S. exports and investment. Since joining the Chamber in 1999, Murphy directed its successful campaigns to win congressional passage of trade agreements with Peru (2007), Central America and the Dominican Republic (2005), and Chile (2003). He plays a key role in the Chamber's work relating to such business priorities as protection of intellectual property, global regulatory cooperation, trade facilitation, and the World Trade Organization's Doha Development Agenda negotiations.*

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