Value for money in regulation?

Justifying regulatory interventions is plagued with many obstacles argue **Martin Lodge** and **Andrea Mennicken**

Governments of all stripes have a tendency to announce bonfires of red tape and reviews of regulatory bodies. This tendency has become ever more pronounced in the current age of austerity. To respond to this potentially existential threat, regulators are under pressure to display their 'value for money' to politicians and better regulation watchers alike. Calling for value for money might appear universally agreeable and it has been a commanding theme in the context of national audit office activities, especially in the UK. However, establishing whether the costs of regulatory interventions are outweighed by wider social benefits is plagued by a number of obstacles.

Firstly, one key obstacle consists in the problem of quantification. As with all instruments in the 'better regulation' toolkit (such as impact assessments), there is a tendency to call for 'hard numbers'. However, this raises issues about what actually can be reliably measured. Few regulatory activities can be associated with easily measurable outputs, let alone outcomes. It might be possible to measure complaint handling response times, number of inspection visits and other running costs, but it is far more problematic to calculate the quality of complaint handling activities, the quality and impact of inspections, or the efficacy of regulatory interventions aimed at preventing (counterfactual) undesirable outcomes.

Furthermore, calls for hard numbers run the risk of biasing decisions towards the immediate, rather than the long-term, future where any calculations will be associated with increased degrees of uncertainty. Even where running costs might be compared, these results have to be seen in the context of wider trade-offs and regulatory objectives. For example, 'economies of scale' might be found to matter: larger regulatory bodies can rely on standardization of business processes, for example in the granting of licenses. However, this has to be seen in the light of other objectives such as calls for specialist bodies that pay undivided attention to a particular activity or profession.

Any attempt aimed at measuring 'value' is faced with a range of complications. Many regulators use surveys of customers and businesses to establish satisfaction levels. However, such surveys are limited in a number of ways. First of all, measuring customer satisfaction might be very good in establishing the transactional quality of the customer-regulated industry interaction. Satisfaction surveys are likely to focus on the immediate interaction between customers and regulated industry rather than on long-term outcomes. However, it is questionable whether customer experience with the process of being given financial advice (i.e. the friendly character of financial advice) should be measured when ultimately the intention of the regulatory regime is to protect consumers and to prevent the purchasing of ill-suited financial products. Such patterns become even more problematic when seeking to measure satisfaction and subjective experiences in areas where customer preferences are highly volatile.

Secondly, not all customers' experiences as expressed through satisfaction surveys offer insights into compliance. Individuals will seek positive decisions rather than being turned down, even if the latter is done in appropriate ways. Even more problematic are attempts aimed at measuring satisfaction among those vulnerable stakeholders who may not be in a position to easily contribute to such exercises (take for example immigrants, prisoners, or citizens with dementia).

The limited nature of regulatory bodies' direct influence on regulated entities represents a further obstacle in establishing value for money. Regulated entities, such as banks, supermarkets or entities operating in the utilities sector, are exposed to multiple regulatory regimes; they are vulnerable to the ups and downs of consumer markets and technological changes; and they are exposed to demands from insurance and capital markets. A particular regulatory agency might produce value for money with respect to one particular area of business conduct, for example in relation to consumer complaints handling, but such impact might be far less relevant when it comes to questions of shaping overall business conduct.

An additional obstacle relates to the basis on which value for money is being established. Any comparison or benchmarking exercise will always be contested. Within a national context, variations across regulatory agencies range from their financial basis, political salience, and differences in the capacities and motivations of regulated entities. Inter-organizational and cross-national benchmarking will always be affected by constitutional and other institutional factors. As a consequence, comparisons will tend to be made with reference to some fictional account of what constitutes 'good practice' rather than being rooted in extensive cost-benefit or performance-based analyses. Linked to the aforementioned constraints on measuring outcomes and outputs, this means that evaluating regulators' value for money will tend to emphasize a focus on process (operational procedures and 'best practice' in this regard) rather than on output or outcome.

Finally, there is the cost of establishing 'value for money'. What value for money lies in value-for-money assessments? At what point do they become too costly to be justified in value-for-money terms? Even where there might be agreement on the type of activities that should be assessed, value-for-money assessments are costly. Such costs arise in a number of ways. One is the cost of gathering and reporting information. Another is the cost of analysing the information and establishing meaningful analysis. The costs connected to generating 'hard numbers' in meaningful value-for-money analyses may prove prohibitive, requiring regulatory bodies to find alternatives, often resulting in reliance on more qualitative forms of evaluation and assessment.

None of these objections are intended to imply that regulators and regulatory interventions should not be held accountable and be required to justify themselves. But attention should not just be paid to the value for money of certain regulatory interventions; instead, focus should also be placed on efficacy and effectiveness of the regulatory system as a whole (namely the management of regulatory interfaces across dispersed administrative and political landscapes), and, last but not least, the 'value for money' of the armies of better regulation czars themselves.

The need to justify and consider regulatory interventions has certainly become more salient in an age of political interest in 'deregulation' and austerity in government finances. However, value for money assessments on their own are unlikely to resolve issues of over-regulation or ineffective regulation. And we need to be careful not to lose sight of the 'value-for-money' of the 'value-for-money' assessments themselves.

Martin Lodge and **Andrea Mennicken** are Director and Deputy Director of **carr**.