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## Introduction

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# Chapter 1

## Introduction

Alberto Alemanno, Frank den Butter, André Nijsen, and Jacopo Torriti

### 1.1 Perspectives on How to Regulate in the Risk Society

The premise of the book is that the quest for regulation is expected to grow in the near future as a consequence of the *emergence of a (world) risk society* (Beck 1992, 1999, 2008, 2011). As an illustration, one may think of how risks related to food, drugs, infectious diseases, climate change, and financial crises have steadily been penetrating all conditions of life in recent times. One of the most immediate consequences of a world risk society is that the decisions, acts, and omissions of few entail risks for many. A major source of these emerging risks entailing large societal damage can be traced to the growing complexity and connectivity brought about by an ever more global economy. As a result, small adverse shocks can have catastrophic consequences (Boin 2010). More formally stated, the complexity and connectivity resulted in risk distribution functions with fat tails. Institutional efforts to manage risks have triggered different attempts to regulate several risk-related activities. Businesses, business' products, and services are an integrated part of most conditions of life and, as such, involve different risks. That is why business regulation must be an integrated part of this stock of risk-based regulation.

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Regulation has a long history. The Code of Hammurabi is a well-preserved Babylonian law code, dating to ca. 1700 BC. It is one of the oldest deciphered writings of significant length in the world. Nearly one-half of the Code (282 laws) deals with matters of contract, establishing for example the wages to be paid to an ox driver or a surgeon. Other provisions set the terms of a transaction, establishing the liability of a builder for a house that collapses, for example, or property that is damaged while left in the care of another.<sup>1</sup> A more recent example of the impact and relevance of regulation appears from the following text part of President's Obama Executive Order of 18 January 2011:

By the authority vested in me as President by the Constitution and the laws of the United States of America, and in order to improve regulation and regulatory review, it is hereby ordered as follows: Section 1. General Principles of Regulation: (a) Our regulatory system must protect public health, welfare, safety, and our environment while promoting economic growth, innovation, competitiveness, and job creation. It must be based on the best available science. It must allow for public participation and an open exchange of ideas. It must promote predictability and reduce uncertainty. It must identify and use the best, most innovative and least burdensome tools for achieving regulatory ends. It must take into account benefits and costs, both quantitative and qualitative. It must ensure that regulations are accessible, consistent, written in plain language, and easy to understand. It must measure, and seek to improve, the actual results of regulatory requirements ...

(Obama 2011).

Many questions could be asked about the origins and functions of regulations. In the context of this book, we confine ourselves to the why and what questions related to regulation.

*Why* regulating? The justification of regulation has different origins. The need to regulate arises from different perspectives: the economic, legal, sociological, political, and public administrative perspective. The economic perspective refers to regulation that aims to enhance economic welfare. The legal perspective refers to the contribution of regulation to conflict solutions, constitutional matters, and civil rights. The sociological perspective refers among others to social control ("regulation as solidified behavior"). The political perspective deals with regulations as instrument in the political process ("regulation as a product of the political system: a compromise"). The public administrative perspective stresses the cybernetic side of regulation (the social order).

*What* regulating? This refers to the so-called policy areas: e.g., financial, fiscal, competition, social security, labor market, environmental, and spatial planning perspective.

The complexities of the risk society call for a multi-lenses approach which covers both the aforementioned "why" and the "what" perspectives. For this reason, the chapters in this book are not solely based on economic argumentation, but also use theories from sociology, from legal science, and from administrative sciences. Therefore, the relevance of the capability-oriented approach—the Human Development Approach developed by Martha Nussbaum and Armatya Sen—should

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<sup>1</sup>[http://en.wikipedia.org/wiki/Codex\\_Hammurabi](http://en.wikipedia.org/wiki/Codex_Hammurabi).

be stressed in a book dealing with business regulation (Sen 2009). To quote Aristotle: “Wealth is evidently not the good we are seeking; for it is merely useful and for the sake of something else” (Aristotle, 384 BC–322 BC).

## 1.2 Risks and Externalities

Because the major topic of this book is business regulation, we commence by elaborating the economic justification of regulation. Traditionally, the economic justification for regulation can be traced to public sector economics and transaction cost economics. The normative approach offered by these subdisciplines offers three main arguments for government intervention driven by societal welfare, namely, redistribution, provision of public goods, and repair of market failure. In the real world of imperfect markets, regulations can be necessary to correct market failures such as externalities (e.g., health, safety and environmental risks), asymmetric information (e.g., in financial or labor markets), and market power (e.g., entry barriers), as well as correcting other problems such as unfair discrimination. To address externalities remains a major aim (if not the principle aim) of regulation (Breyer 1993). Yet such repair is acceptable only when the costs of regulatory action (costs of regulation, government failure) are smaller than the welfare gains from the intervention. Risk-based regulation seeks to repair market failure at lowest possible costs. In particular, within a risk society, a predominant role is played by insurance and risk prevention. The most obvious justification for governmental intervention in these areas is that regulation (and/or sufficient prevention) is needed in case insurance cannot, for some reason, be provided by the private sector. Here it is capital market imperfection as market failure that calls for regulation. However, also aspects of redistribution can be linked to public sector provision of insurance. This is, for instance, the case when there are social preferences for risk solidarity, i.e. when people with different risk profiles are to pay the same premiums. Other examples are unemployment insurance, disability provisions, and in some countries, standard health insurance. A major concern for regulation in these cases is, like in commercial insurance, to avoid moral hazard but also to avoid adverse selection and cherry picking. Another major area of concern for the regulator of a “risk society” is lifestyle risks, i.e. the way individuals address daily choices affecting their well-being (tobacco, alcohol, obesity, etc.) (Planzer and Alemanno 2010). Similar to rising greenhouse gases and environmental degradation, lifestyle risks largely derive from another detrimental effect of individual and corporate consumption. As illustrated by the ongoing obesity pandemic, these new risks are increasingly calling for the attention of policy-makers across the globe. Until now, government’s stance to lifestyle risks has relied heavily on self-regulation, as illustrated by the schemes concluded by the food and beverage industry both in the USA and the EU, and also the fancy “nudge” approach (Thaler and Sunstein 2009). However, the economic perspective seems to emerge showing that market failure might provide a solid argument for government intervention with respect to the prevention of obesity

(Anand and Gray 2009). The same argument may apply to other government intervention in lifestyle choices which bring about externalities. An example is the prohibition to smoke in pubs and public places.

Although regulation can solve social problems, it can also impose its own problems, including compliance costs, inhibition of innovation, ancillary risks, and rent-seeking. This is illustrated in Chap. 6, which discusses the costs and benefits of banking regulation and supervision. In the light of the above, the perspective of transaction cost economics is relevant because regulation inevitably brings about implementation costs. Transaction cost economics and the related theory of new institutional economics (Ménard and Shirley 2005) provide ideas about how to institutionalize regulation so that these costs are minimized. Moreover, regulators may make mistakes, may choose poorly designed regulations, may neglect social goals other than their own narrow mission (Breyer 1993), may neglect the adverse impacts of their decisions, may aggrandize their own power, or may serve the interests of narrow groups rather than promoting broader public well-being (Kolko 1965; Ackerman and Hassler 1981). There is also another important shortcoming that it is inherent to any attempt at systematically addressing the pressing demands of a risk society. Often, regulators may pursue policies that reduce some risks while introducing new risks or shifting risks to other populations (risk–risk tradeoffs) (Graham and Wiener 1995). This tends to occur when regulators are hampered by limited information, bounded decision domains, or the omitted voice of the affected populations.

The main concept interconnecting societal risks and optimal government regulation is the notion of trust. This is exemplified by Chap. 10 when discussing the role played by trust in pharmaceutical regulation. Under transaction cost economics, trust is identified with calculative trust where cheating and a holdup in an explicit or implicit contract based on trust are avoided by the condition that the gain from cheating does not outweigh the costs of the loss of trust and reputation in the horizontal trade, or vertical principal/agent relationship. It is in accordance with Greif's (2000) way of describing an institutional setup as solution of the game of trust for the fundamental problem of exchange. This fundamental problem of exchange is, in principle, similar in a horizontal trade transaction and in a vertical G2B relation, which is relevant in the case of regulation.

### 1.3 Role of Government in a Risk Society

A rich literature has attempted to deal with similar issues in an attempt to interpret Beck's vision of a world risk society. Building upon these perspectives, our reading of Beck's foundational concept of risk society is that the costs associated with risks and with risk avoidance are increasingly perceived by the public as the responsibility of the government. The government has the dual role of bearing the costs of prevention and compensating the public should the risk materialize. Globalization leads

societies to become more and more entangled. It also enhances the danger of contagion (see the credit crisis and the N1N1 epidemic). This is one reason that makes it harder for the government to timely and adequately address the demands of a risk society. This volume explores some of the trade-offs existing between businesses asking for less regulation and those demanding for more regulation.

There is another reason that makes the government's job to deal with the demands from society difficult. The shift of responsibility for the risks to the government enhances the moral hazard of the society in taking risks (again see the credit crisis). In a way it is "privatizing the gains from taking risks and socializing the losses from taking risks." One of the major shortcomings stemming from any regulation addressing these demands of the risk society is that it becomes increasingly more rules-based rather than principle-based or even trust-based. This leads to a shift from intrinsic motivation to comply with rules and regulations associated with risks and risk prevention to extrinsic motivation to abide by the rules. This shift may be very costly because extrinsic motivation leads to more transaction costs (in this case monitoring and bonding costs, see Chap. 7) than trust-based regulation. That led the former prime minister of the Netherlands, Jan Peter Balkenende, as well as the current UK PM, David Cameron, to operationalize Amitai Etzioni's ideas about aiming at a more communitarian (or "Big") society and to promote "self-responsibility" of the private sector (see e.g., Etzioni 2009). This reliance on self-responsibility can be seen as a third road between the (libertarian) idea of letting the market regulate and the (paternalistic) idea of making the government fully responsible for our well-being. It must be recognized that all attempts at operationalizing these ideas have not been successful (see the efforts of Balkenende, Cameron, and Obama to convert these theoretical ideas into policy practice). Yet, the road back from extrinsic to intrinsic motivation is a difficult one. That is the major dilemma any call for less regulation, or at least less costly regulation, faces today in a modern risk society where the need for regulation and international coordination of regulation increases.

## 1.4 Purpose of the Book

The main purpose of this book is to provide a portrait of the multiple challenges associated with a risk society. Whilst using different disciplinary approaches, the book is characterized by a single driver, namely, to present current issues pertinent to the risk society. In so doing, it touches upon aspects of climate change, food safety, financial crisis, and trust, but also on how to measure the costs and benefits of regulation. The authors hope that readers may find in this book useful contextual information regarding various instances of risk society. This book might inform policy-makers about the business climate, social context, and environmental conditions of a risk society. Ultimately the multiple realities of the risk society might help design public goals through risk-based regulation. From that perspective, a major

research question in the book is how can regulation reckon with public and private interests at low costs, so that there will be support for the regulatory measures and so that distortions from regulation could be minimized and the benefits from regulations could be maximized. The welfare gain that the repair of market failures by regulation brings about should, at least, outweigh the welfare loss of that distortion. In Chap. 14 the book pays attention to the Standard Cost Model (SCM) as a practical policy tool to come to a more efficient business regulation. The SCM is positioned here in relation to other regulatory reform instruments such as regulatory impact assessment (RIA). Among the many questions discussed in the book: what are the different perspectives of these different instruments of regulatory impact assessment? How can they be connected? How can this way of thinking and looking help us to integrate these instruments into a more coherent system of regulatory impact assessments which we will need to tackle the challenges of the risk society in a more effective and efficient way? The final question to be answered is: what will be the consequences of this synthetic view for the existing proceedings of law producing?

## 1.5 Overview of the Book

The book starts and finishes with two editorial chapters: Chap. 1 Introduction and Chap. 17 Conclusions. The content of the book is divided into three topic areas:

- Social risks and business regulation: Chaps. 2–6
- Preconditions for better business regulation and international coordination: Chaps. 7–12
- Theoretical and measurement issues related to better business regulation: Chaps. 13–16

First, social risks and business regulation will be explored by starting a discussion about the role of risk management in the risk society and what risk management by regulation can offer. Following this general introduction the focus shifts to the emergence of EU-risk regulation and to the examination of three different specific types of social risks: global climate change, the Agro/Food sector, and financial risks. Virtually all these forms of regulation, by addressing social risks, face a common challenge: how to repair market failure at minimum costs in a global economy where worldwide interdependencies become increasingly important.

In the second part of the book, the attention shifts to an analysis of the preconditions to be fulfilled from the perspective of public sector economics in order to achieve better business regulation in a risk society. Part of these preconditions consists in the advice to broaden the view on regulatory costs so as to include insights from transaction cost theory. The next lessons learned will then be presented by discussing reduction policies with a focus on administrative burden for businesses. Other important elements of better regulation policies are the necessity of a cultural shift in the mind of lawmakers and the question of whether trusting businesses might be a more efficient “regulatory instrument” than mistrusting businesses.

The next theme deals with the cross-border problems of how to regulate international collusion and risks associated with trade. Here the focus is on regulation in the EU and on the activities of the WTO.

The third part of the book discusses some theoretical issues related to better business regulation in a risk society. After an introduction chapter with an overview of topics related to business regulation, elements of this discussion are the positioning and role of the SCM as an instrument to tackle bad regulation, the number of regulations in an analogy of the Laffer curve (does a regulatory optimum exist related to social welfare?), and theoretical reflections about the lessons learned with sunset regulation in Germany, Australia, and USA.

The book concludes by drawing lessons about how to improve the regulatory process in the risk society. For that reason the book pays ample attention to technical and economic criteria, rather than prioritizing political or legal criteria—as is too often the case today. A multiplicity of cases is considered. At the expense of oversimplifying, at the one end of the spectrum there are cases where regulated businesses are provided with the conditions to compete at the lowest possible costs, without jeopardizing the related public goals, and with high compliance levels. At the other end of the spectrum there are cases where the complexities of the risk society make it difficult for businesses and policy-makers to have flawless risk-based regulation, full economic trust, and limited transaction costs. This book shows that several cases from various sectors are placed in between these two ends of the spectrum.

## 1.6 Contents

### 1.6.1 *Part I: Social Risks and Business Regulation*

*Chapter 2* identifies the requirements for a risk governance framework inspired by the works of the International Risk Governance Council (IRGC). Risk governance faces three major challenges that result from a lack of knowledge and/or competing knowledge claims about the risk problem: complexity, scientific uncertainty, and sociopolitical ambiguity. In examining these three challenges, the chapter promotes a risk governance model that expands the classical model of risk analysis (risk assessment, management, communication) by including steps of pre-estimation, interdisciplinary risk estimation, risk characterization and evaluation, risk management, as well as monitoring and control. This new risk governance model also incorporates expert, stakeholder, and public involvement as a core feature at the stage of communication and deliberation.

*Chapter 3* explores how the European Union addresses the challenges brought about by the emergence of a “risk society.” After reconstructing the genesis and evolution of EU risk regulations, i.e. regulations aimed at the protection of health,



safety, and the environment, it identifies the main features of the EU approach towards risk. Although the EU institutions have not adopted a harmonized and consistent analytical approach to risk, notably to scientific risk assessment—given that it is conducted by different bodies following diverging methods—it is possible to discern some common and distinctive features in the risk analysis framework that has been gradually adopted to manage an ever-wider range of societal risks (such as food safety, chemicals, pharmaceuticals, medical devices, crop protection, and GMOs). The chapter argues that, by subscribing to a progressive ideal of regulation based on expertise, an embryonic European risk regulation model is taking shape and developing today. Yet a tension between the necessity for a rational, evidence-based decision-making and the wider demand for a flexible, precautionary-oriented regulatory approach represents the defining feature of the EU decision-making paradigm of risk regulation.

*Chapter 4* takes as a starting point the statement made in December 2010 when the international community affirmed that “climate change is one of the greatest challenges of our time.” Parties to the United Nations Framework Convention on Climate Change (UNFCCC) further recognized that “warming of the climate system is *unequivocal* and that most of the observed increase in global average temperatures since the mid twentieth century is *very likely* due to the observed increase in anthropogenic greenhouse gas concentrations.” Climate change represents what economists call a “public good.” The theory of public sector economics teaches that provision of any public good is riddled with challenges of collective action, the incentive to free-ride; the more so when the required collective action is a global one. In addition, the fact that the adverse effects of climate change are distributed asymmetrically—those which contributed the least suffering the most and being the least capable to mitigate as well as adapt to the changes—further exacerbates the incentives to maintain and sustain the collective action required to overcome this challenge. International efforts resulted in a general framework to fight climate change in the form of the UNFCCC. Measures to implement this general framework are embodied in transitory mechanisms embodied in the Kyoto Protocol, the only international instrument providing for legally binding reduction and limitation targets for developed countries together with flexibility mechanisms to ensure the cost-effectiveness of reduction measures. Regulation with respect to climate change provides a prime example of the difficulties in coordinating the repair of market failure in the global economy, where countries have different stakes and prospects to be hit by their own actions and by actions of others.

*Chapter 5*'s objective is to identify the main legal barriers to the competitiveness of the European food industry and to suggest ways to improve the legal system. Prior studies have shown that competitiveness of this industry is under pressure. The chapter proposes a second overhaul of European food law, after the tremendous legal efforts that have been made as a response to food scares at the turn of the century. The proposed reform consists of eight improvements of European food law combined to a recommendation aimed at empowering stakeholders upstream in food supply chains. These improvements would not only contribute to the competitiveness of

the EU food supply chains through alleviation of various forms of administrative burdens, but also restore the power equilibrium between stakeholders within the food chain as well as between businesses and consumers and reduce the burdens connected to pre-market approval of food and feed and zero-tolerance standards. These focal areas partly overlap, as the improvement of one area may positively or negatively affect another. Within the proposed second overhaul of European food law, the rights of all stakeholders should be considered, while at present consumer concerns seem to eclipse the interests of other stakeholders.

*Chapter 6* analyzes costs and benefits of banking regulation and supervision to determine whether more supervision is always better for the functioning and stability of the banking sector. Whilst the motives for additional regulation are well understood, their social costs are not and hence net social benefits of additional regulation remain unclear. It is emphasized that also in regulatory terms there is no free lunch; regulation—much like taxation—creates social costs and these may exceed the benefits so that society is actually worse off with than without (additional) regulation. And the argument is even more intricate than that, suggesting that if the layers of regulation in place before the crisis have given poor incentives to those in the financial industry and their clients, a revision or even reduction of regulation might generate a more stable financial system that is friendlier towards its customers. Financial regulation proposals, like those of Basel III, should ultimately align the behavior of financial institutions with social preferences. That strongly implies that the political discussion on regulatory proposals should reflect a full overview of relevant benefits and costs. The chapter argues that the current situation is far from this theoretical optimum. Politicians voice the public outrage over financial institutions that are supposedly at the root of the global financial crisis and often seem most intent to increase consumer protection and reduce tax payer exposure.

The common theme of the Chaps. 2 and 3 is how to create regulatory instruments to tackle the risk of the risk society. A common theme of Chaps. 4–6 is that a major reason for government regulation is repair of market failure, or more specifically internalizing externalities. Examples are drawn from environmental and safety regulations, prescriptions on working conditions, various types of permits which prevent businesses to make decisions at the costs of others, and financial regulations.

### ***1.6.2 Part II: Preconditions for Better Business Regulation and International Coordination***

*Chapter 7* discusses a common characteristic of all of the different types of government regulations, namely that they entail implementation costs which, like taxes, distort efficient allocation in the ideal general equilibrium. These costs can be quite substantial but tend to be overlooked in the discussion and development of government policy. By applying the perspective of transaction cost economics, this chapter considers the costs arising from regulation in a principal/agent model. Three types of transaction costs can be distinguished, namely, (1) monitoring costs of the

regulator (principal); (2) bonding costs by the regulated private economic entities (agent); and (3) the costs of residual loss in case the result of the regulation is not in compliance with the targets set by the regulating authorities. These latter costs can be regarded as cost to society due to, e.g., miscommunication on the aims of regulation and are, of course, hard to quantify. Bonding and monitoring costs consist of both “hard” and “soft” transaction costs. Hard transaction costs are direct costs and are easy to quantify. Soft transaction costs are indirect costs and are hard, or even impossible, to quantify. The costs of residual loss are welfare losses and can be typified as soft transaction costs. The main benefit of regulatory measures is the avoidance of societal costs that would occur in a situation where regulation is meager or absent. Therefore, it may be welfare enhancing if regulations are fashioned in such a way that net benefits are optimized. From that perspective the chapter looks at the possibility to select optimal regulation by means of a cost/benefit analysis.

*Chapter 8* discusses how from the 1980s onwards, an increasing number of countries has conducted an economic policy where the role of the government, and therefore the extent of regulation, was reduced. The idea was that in a scenario of less government, i.e. lower tax and premium rates, lower deficits, lower debts, less regulation, and less compliance costs, markets would function better. It would enhance economic development. The good performance of the US and UK economies—and later that of many other economies—in the late 1990s seemed to support this approach. However, the internet crisis around 2000 and the dramatic financial and economic crisis of 2007–2010 changed these ideas about the retreat of the government being favorable for economic development. From that perspective this chapter wonders whether full reliance on the invisible hand of market forces is really beneficial, and whether less government and less rules and regulations are really the right alternatives to realize the most desirable pattern of economic development. What is the relationship between the level of compliance and the pattern of economic development? Has it helped countries to better deal with the impact of the recent economic crisis? These questions are investigated in an empirical analysis, considering relationships both between countries and over time, and using data from World Bank and OECD. The results are at variance with the predominant conventional wisdom of the proponents of deregulation: less regulation seems not to have been beneficial for economic development and also has not made countries better able to deal with the recent financial and economic crisis. Even though these analyses can be regarded as preliminary and a starting point for further study, the results produced in this chapter do show that a reduction of regulation has not been as beneficial to the economic performance, as many had believed thus far.

*Chapter 9* addresses the complementarities of culture (bottom up) and structure (top down) for the reduction of regulatory burdens. It specifically looks into the case of the Netherlands; however, the lessons learned are generic in kind. Dutch policies on better regulation aim at a cultural shift and structural safeguards. It is found that besides a supportive culture within ministries, it is necessary to establish adequate structures on reducing regulatory burdens. A sole reliance on internal pressures leads to unpredictable outcomes. For a consequent application of routines and procedures that ensure that administrative burdens are accounted for structural

safeguards must be in place. Such safeguards comprise of a separate conduct of scrutiny, accountability (and/or transparency of the effects) and the attribution of responsibility, and, consequently, problem ownership. It is found that a real separation of scrutiny function and legislation function is necessary. Both tasks may comprise of different skills, values, loyalties, and responsibilities. This calls for an enduring structure of checks and balances to ensure the attention for regulatory burdens in the policy process.

*Chapter 10* discusses government regulation and trust. In recent years trust has been employed in academic, industry, and policy circles as a common buzzword to describe some of the most complex issues underpinning the relationship between industry and regulators in relation to risk. The ongoing perception of a trust crisis in the pharmaceutical sector is the starting point for analyzing how institutional trust is construed by the pharmaceutical industry. Through evidence collected from a set of interviews to individuals working in the pharmaceutical sector, this chapter examines what is meant when the industry talks about trust in respect to regulators. The chapter reviews the three broad functions of trust in relation to institutions as identified in the vast literature on trust; it details the role of the media in relation to trust vis-à-vis regulators and the industry; it defines which applied functions of trust were identified from the interviews; it considers the problems associated with making trust operational from an industry perspective; and it speculates on what can be learned for other sectors. By relying on a set of interviews, it delineates five typologies of trust which coincide with the diverse roles this plays for the various constituents

*Chapter 11*, by taking the perspective of the risk society and building upon the findings of recent research, illustrates a number of examples of loss of competitiveness resulting from non-transparent, non-streamlined, ineffective, double, or non-harmonized legislation and enforcement between Member States and regions in Europe. In particular, the chapter shows that “cross-border barriers” may lead to serious costs and burden for business. Furthermore it seems that these costs and burdens have not been tackled during the more than 20 years of so-called “better regulation initiatives” in Europe. These initiatives were basically Member-State oriented and focused on European and national legislation separately. An integrated cross-border approach to control cross-border consistency does exist neither at the EU- nor at a national level. Introduction of a new multilayer approach, in which assessment not only covers national and European impact, but also cross-border effects, is presented as a possible solution to this system failure. As part of the European Regulatory Impact Assessment (RIA) procedure, this approach could lead to a new legislative principle of “cross-border consistency” and furthermore to the development of a practical “cross-border consistency check” to transform the existing EU legislative procedure from “better” to “best regulation.” Such a new legislative principle could beforehand draw attention to possible ways to avoid adverse effects of differences in legislation and procedures. Solutions could be found by more harmonization or streamlining but also by more transparency and overview over the existing differences.

*Chapter 12* discusses the role of globalization for world trade. The world economy has become key for economic development because a business environment is

created for operation of global companies. In the last decades international trade between countries has reached unprecedented volumes, but this rise has been accompanied by the emergence in global risks, often hidden as nontariff barriers to trade (NTBs). Apart from traditional commercial risks, countries and global companies are faced with a wide variety of noncommercial risks, like political, societal, and ecological risks. In order to tackle this emerging number of obstacles to trade, countries agreed to establish an international economic organization as an important international legal instrument: the World Trade Organization (WTO). The basic principles of WTO guarantee nondiscrimination and predictability in trade relations of WTO member countries. The WTO agreements, by establishing the legal framework for a multilateral trading system, aim at governing the risks of unpredictable acts of WTO member governments. Yet as of today the most important achievement of the WTO is the phasing out of tariff barriers. However, to effectively address the mounting number of NTBs, risk analysis was integrated in the WTO Sanitary and Phytosanitary Agreement (SPS). It requires that scientific evidence be advanced when introducing domestic regulations that may have negative effect on international trade. In spite of the great efforts of countries to eliminate global risks, new risks constantly appear. The ongoing round of multilateral trade negotiation in the WTO should aim at removing these obstacles to international trade.

Awareness of regulatory costs and regulation as such, the effect of national regulations in international and cross-border settings, and internalization and trust are the common themes in Chaps. 7–12.

### ***1.6.3 Part III: Theoretical and Measurement Issues Related to Better Business Regulation***

*Chapter 13* discusses the role played by the OECD in regulatory reform. Over the past 15 years, the Organization for Economic Co-operation and Development (OECD) has played a pioneering role in bringing the issue of regulatory reform to the fore. Much has been achieved over the years, with many countries benefitting from the potential offered by quality regulation. Still, the recent crisis exposed massive flaws in regulation, as well as in supervision and enforcement. Other events are also testing the limits of regulatory frameworks. Regulatory policy is currently at the crossroads, as it needs to integrate a broader governance perspective to address current and future challenges. The chapter takes stock of the current debate on regulatory reform and discusses possible pathways to address the goal of the future agenda—i.e. restoring trust in government through effective regulatory governance. This involves a tighter integration between the organization and the management of reform. It also requires completing the policy cycle, closing the loop between regulatory design and evaluation of outcomes, with evidence-based approaches to support proportionate decisions and policy coherence and better assessment of the benefits of regulation.

*Chapter 14* is devoted to a detailed and critical analysis of the Standard Cost model (SCM). This is a policy instrument for measuring the compliance costs of legal information obligations from businesses, institutions, and civilians to government and governmental institutions. The main function of these information obligations is to allow government monitoring compliance. Since 2003, the first generation of the SCM—SCM 1.0—spread very quickly over more than 20 countries. Yet, now that its use has proliferated and many practical experiences are available, time has come for a critical check. This could provide thoughts for improvement and elaboration of the model towards a new generation of the SCM, the SCM 2.0. Looking from the perspective of a risk society, it becomes apparent that a strategy of deregulation should be replaced by a strategy of better (business) regulation. After all, better regulation is one of the cornerstones for effective risk management. How could a SCM 2.0 fit in such a strategy? Strong features of the SCM are its capacity to reduce complexity—standardization of compliance—and its flexibility. These features seem to fit to the mainstream theories on policy-making: bounded rationality of the “administrative man,” mixed scanning, incrementalism, and nonsequential policy stages. The big challenges for the next generation of the SCM—SCM 2.0—are to add modules for standardized financial and substantive compliance costs and standardized benefits. In addition, a safeguard against compromising political rationality should be constructed, inspired by the technical rationality, the means to achieve the public goals of the risk society. The SCM 2.0 could be helpful in this respect.

*Chapter 15* discusses the regulatory costs of taxation from an economic point of view. First, a theoretical Laffer curve for tax regulatory costs is developed. This curve shows that there is an optimum somewhere between too much and too little regulation. In that respect the chapter intermediates between the findings of Chap. 6 that the new regulations for the banking industry, in reaction to the credit crisis, may be too costly for society, and the findings of Chap. 8 that less regulation has not been beneficial to society. From this perspective Chap. 15 provides an overview of the literature on tax regulatory costs. Finally, some remarks are made about the incidence of a tax regulatory Laffer curve.

*Chapter 16* surveys the use of sunset legislation in three countries, namely, USA, Australia, and Germany. A sunset clause causes a particular law or statutory instrument to expire after a fixed number of years; a sunset clause has two main characteristics. First, by shifting the burden of proof from those who would terminate a regulation to those who want to renew it, it creates a “threat of termination.” Second, an inclusion of a sunset clause requires a periodic review and evaluation of the effectiveness and efficiency of government functions and programs. Based on theoretical reflections of policy termination and evaluation, the chapter analyzes the empirical experiences on how sunset legislation can foster different policy goals and discusses the possibilities to connect sunset legislation to risk-based decision-making. If used systematically for selected laws, sunset setting can be a feasible instrument to support better business regulation.

The common theme of the Chaps. 13–16 is taking stock of existing regulatory policies and instruments in order to find new ways to better regulations.

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