

Brussels, December 4th 2012

# THE RISE OF THE EUROPEAN REGULATORY STATE – HOW TO FIGHT IT (BETTER)?

Manuel DIERICKX VISSCHERS

AECR & LIBERA!

# Content Table

## Part I

- The rise of the European regulatory state and its (hidden) costs
- Sense and non-sense of its causes
- The limited success of Impact Assessment
- The judicial review of regulatory quality
- Preliminary conclusions

## Part II

- A better understanding of the problem
- Property rights and 'regulatory takings'
- The need for a nomocratic RIA
- A case study
- Final conclusions

# The rise of the European regulatory state and its (hidden) costs

- Is there a European regulatory state? Yes!
  - 150,000 pages of Internal Market regulation: amount of regulation
  - Some figures from study of OpenEurope: regulatory pressure
    - Since 1998, 71% of all regulations in UK is originated in EU
    - Cumulated price tag of EU regulations is £124 billion
    - Of which: employment (22%) and environmental (18%)
    - In 2009 in UK: extra cost of £19.3 billion of total £32.8 billion
- Regulatory pressure will probably increase in the future, due
  - Completion of the harmonizing Internal Market in ever more new domains (cfr. the “Interstate Commerce Clause” in the US)
  - Decrease of budget for social and environmental policies, probably leading to a shift towards more regulations enforcing those policies
  - Intensifying power struggle between the European Commission, the Council and the European Parliament, probably leading to an “advance bidding” in ever more regulations

# The rise of the European regulatory state and its (hidden) costs

- Visible costs of regulation (Chicago School)
  - Compliance costs for companies and citizens
  - Efficiency losses (dead weight losses), due to less optimal functioning of the market
- But there are more hidden costs of regulations
  - Austrian School: Distortion in normal process of solving the of information problem
  - Neo-institutional economics: undermining of fundamental institutions (including rules and values) for functioning of market
    - => Less entrepreneurship and innovation in a dynamic economy, leading to lower economic growth
    - => 'Moral hazards' and 'political favouritism' (increasing 'rent seeking' by pressure groups and political struggles by politicians)

# Sense and non-sense of its causes

- Four classic market failures:
  - Monopolies and market dominance
  - Public goods and (social) services
  - Information asymmetries
  - (Negative) externalities
- But seminal study of Winston states that there exists no perfect market, and market failures are less problematic than thought:
  - Much more competition and more market entry of new-comers in real markets (almost no problem with 'natural monopoly');
  - Much less need for providing public goods than anticipated (exclusion costs are lower than previously thought);
  - In long run, information asymmetries disappear + Hayek points out that economic processes are all about 'information seeking';
  - Negative externalities can be corrected voluntarily when there are low transaction costs (Coase theorem).

# Sense and non-sense of its causes

- Government failures are on closer look the real culprit for the lack of regulatory quality
- Supply and demand of regulation – regulation is not 'deus ex machina' but a commodity which produces wealth for some – originated by G. Stigler
- Public choice theory: three fundamental 'interests' and interest groups when developing regulations
  - Politicians that want to win elections
  - Pressure groups that want rent-seeking
  - Bureaucrats that want influence and budget

=> They make a trade-off when developing regulations

# The limited success of the Impact Assessment (IA) in the EU

- The Impact assessment was originally introduced in the EU in order to make ex ante evaluation of (impacts of) regulations more objective and scientifically (empirically) justified, in order to avoid or at least to mitigate political 'wheeling and dealing'
- But the success of the (R)IA, based on CBA, in improving the regulatory quality is limited (study of Hahn)
- Moreover, even the quality of IA practice is limited => Renda report
- Clearly, (R)IA is 'plateau-ing'. There is RIA fatigue.

# The limited success of the Impact Assessment (IA) in the EU

- What are the reasons for this lack of success?
  - The methodological difficulties of CBA (Cost Benefit Analysis):
    - foundation of CBA, the 'homo oeconomicus', does not exist completely (behavioural economics);
    - conflict between efficiency and other values;
    - lack of sufficient empirical data that reflect the societal complexity and the impact of regulations on it
  - The political environment in which the RIA has to function:
    - RIA methodology is changed in favour of specific political ideologies (discount rate + private and co-benefits)
    - RIA performers are also biased (captured by pressure groups + suffer from tunnel vision)
- ⇒ "RIA will not stop an elephant"
- Some scholars even claim that RIA is even helping pressure groups



# The judicial review of regulatory quality

- In order to stop the “political drivers”, leading to an overload of regulations of poor quality, institutional gatekeepers must be developed => the need for judicial review of regulations as a result of ‘checks and balances’ (cfr. ECHR)
- But on closer look, this is only a marginal check: only an obvious lack of regulatory quality is sanctioned => seldom applied, therefore leading to legal uncertainty for legal subjects and has very little impact on lawmaking and lawmakers
- New developments at the ECJ (Vodafone case): RIA becomes an essential part of proportionality test but the crucial question remains to what extent

# The judicial review of regulatory quality

- Usually there are two ('official') causes for this judicial deference towards regulations
- Complexity of the cost benefit analysis, leading to vague and dubious analysis results of regulatory quality (cfr. the same problem as the lack of success of RIA)
- Fear of a 'gouvernement des juges': it is very difficult to abolish democratically legitimized decisions
- Other non-official causes: lack of feeling with economic reasoning by judges/lawyers + plain 'laziness' of judges when adjudicating
- The question now becomes: how to remedy these two official causes? (the other two are just "all too human")

# Preliminary conclusions

- 2 solutions are offered but do not satisfy on closer look:
- 1. Judicial review of regulatory quality, based on structuralism ('improving the democratic structure of the government') BUT
- How to test the intrinsic quality of a RIA in order to prevent the government in making pure formalistic RIAs?
- What does 'democratic structure' exactly means? Participation of stakeholders? But will this not lead us to more interference by pressure groups?

# Preliminary conclusions

- 2. Insights of behavioural **Law and** Economics ('nudging' or 'libertarian paternalism' – government intervention based on the insights of behavioural economics ) BUT
- How to prevent the crucial government failures ('knowledge problem' and public choice drivers)?
- Methodological problem: there is no such thing as 'perfect markets' in order to determine how market participants should behave more rationally (cfr. the same problem as CBA)

# A better understanding of the problem

- In the beginning, there was “Law, Legislation and Liberty” by F. von Hayek
- Law (‘nomocratic’ by nature) entails individual liberty because it is based on spontaneous order
- Legislation (telocratic by nature) is a risk for liberty because it enforces political will
- Cfr. Aristototele: “Law is Reason without wishes”
- Cfr. Manuel Dierickx Visschers: “Regulations are wishes without Reason” ;-)

# A better understanding of the problem

- Why are telocratic regulations potentially dangerous for society?
- Telocratic regulations are based on a constructivistic fallacy: a belief that society can be designed and constructed rationally
- Nomocratic law (property, free contracting) is undermined by telocratic regulations => breakdown of free market (and even civilization)
- Individual liberties are sacrificed on the altar of policy making (and power struggles)

# Property rights and regulatory takings

- How to protect democratic property rights against regulations? – How to deal with regulatory takings?
- In the US: Bill of Rights: “Due Process Clause”, “Takings Clause” and “Just Compensation Clause”
- In the EU: EU charter of Fundamental Rights – art. 17. “Right to property”
- PS. How does this relate to the European Convention on Human Rights, First Protocol (art. 1. property rights)?
- How do courts proceed in their safeguarding of these fundamental rights and liberties?

# Property rights and regulatory takings

- In the US: safeguarding is problematic, due to
  - threshold approach: only a complete regulatory taking leads to compensation. But what about a partial regulatory taking, let's say between 50 to 90% decrease of value of property
  - Supreme Court does not (want to) question the "ratio legis" of regulation (judicial deference)
- ⇒ Property right undeservedly considered the as 'poor cousin' of the constitutional rights and freedoms
- In the EU, next to ECHR, with rulings 'Volker under Markus Schecke' and "Test-Achats", the protection of individual rights was invoked.
  - What about Structuralism? What does that mean in these cases?
  - Will the property right also be considered as the 'poor cousin'?
- ⇒ But overall lack of quality in the court's analysis of facts



# The need for a 'Nomocratic' RIA

- Nomocratic RIA is based on the classic RIA but focuses on supporting courts in their task to safeguard property rights. How?
- Nomocratic RIA is based on the insights of Neo-Institutional Economics and evolutionary economics (part of Austrian School)
- Nomocratic RIA has no intention of knowing all the impacts of particular regulation on society because they can not be known anyhow, and has therefore a manageable approach
- Questions of a nomocratic RIA are to some extent the same as the classic RIA, like
  - Analysis of societal problems
  - The link between policy goals and societal problems
  - Detection of feasible policy instruments

# The need for a 'Nomocratic' RIA

- But the nomocratic RIA focuses:
  - In the chapter 'problem analysis and goal setting': the nomocratic or telocratic nature of the societal problem and the linked policy aim
  - In the chapter 'options': the nature of the policy instrument (open-ended and order-creating or policy-driven)
  - In the chapter 'impacts': to what extent are the classic economic rights eroded or undermined by telocratic policy interventions, in the short and long run, in a direct and indirect way
- When using the nomocratic RIA, courts are (more) able to avoid the problems of methodological uncertainty/difficulties and the fear of a 'gouvernement des juges' (because they no longer have to deal with general welfare of regulations in abstracto but can focus on tension field between individual rights and the general welfare)

# A case study

- EU legislation on consumer protection in the financial sector (mentioned in Ph.D. dissertation of dr. Renda)
- Misconception of situation by European Commission:
  - Policy aim: a per se prohibition of tying regardless of actual market power because tying increases switching costs and reduces consumer mobility and thus competition
  - BUT: in retail financial services, customers like tying and are reluctant to mix and match because they have invested in a fiduciary tie with financial service provider
    - + providers developed other forms of bundling and mixing of financial products
    - + many economies of scope when combining products and services
- By pretending to know it better: the EU regulation creates a decrease in consumer and producer welfare surpluses
- According to dr. Renda: Behavioural law and economics provides answer by focusing on the actual human behaviour and behaviour changes to new situations, not on static welfare analysis and price theory => to my opinion, this is only correct insofar as it draws attention to the actual behaviour of consumers and providers

# A case study

- What Neo-institutional and Austrian economics teach:
  - Market processes are about solving the knowledge problem and coping with transaction costs => learning process requiring time to correct initial mistakes + no optimal static market setting
  - Consumer preferences are subjective (lower prices may be a preference, but low transaction costs (convenience) may be too)
  - Interference in basic rules can only be justified on grounds of severe market disfunctioning (f.ex. no transactions at all)
- Additional elements of nomocratic RIA
  - Problem analysis: is there really a problem of market power abuse or information asymmetry (keeping essential information secret, leading to a halt in market transactions)? Answer: no real market distortion
  - Policy goal is telocratic: protecting 'poor consumers' against bad banks
  - Options: first, do no harm and choose least intrusive instrument, also in order to avoid costly evasive manoeuvres by market parties
  - Impacts: by limiting free contracting, the regulation leads to severe decreases in producer and consumer welfare in the broad sense

# Final conclusions

- A renewed mind set in viewing regulatory quality is necessary to protect a true free market in EU
- View regulatory quality in function of regulatory pressures on economic liberties (are increasing)
- Accept the fundamental importance of classic or nomocratic economic rights as the basis of our economic order (open-ended and spontaneously evolved without a specific aim (no advantaging))
- Property rights are not 'just for the rich', but provide stability in order to solve knowledge problem and develop individual autonomy
- There is a limit in undermining these property rights!

# Final conclusions

- The democratic system can clearly not correct itself spontaneously (risk of total implosion)
- Therefore: courts, dare to do your job and restore the highly needed checks and balances
- Scalia vs. Epstein (in favour of Epstein's thinking)
- Without this judicial support and effort, all constitutional liberties , bill of rights or chartes with human rights are useless => they have to be enforced with aid of analytical tools
- Judges, do not run away from analysis of societal issues and of the impact of regulations on society (dismiss Kelsian thinking as void)