

Developing the Craft of Regulation

Interview with Malcolm Sparrow

Ethos spoke to Professor Sparrow about the different types of regulation, how to develop good regulatory practices and frameworks, and his impressions of Singapore's approach at this point in its journey towards a new model of regulation.

What is the difference between economic and social regulation? What are some of the different considerations guiding each area or what do you see as the different challenges in each area?

Social regulation normally takes a class of risks but looks at it across all industries. It could deal with environmental risk, occupational hazards or transportation safety as opposed to transportation design. Economic regulation is typically structured industry by industry—the energy sector, the telecommunications sector, the transportation sector—and the goals are slightly more mixed. In economic regulation, you are not only controlling various harms but you are greatly concerned with the efficient functioning of markets and also in the allocation of scarce resources. That's the classic distinction.

What about economic regulations with social objectives?

The boundary between them is fuzzy. If you look at something like financial regulation, that sounds to a lot of people awfully like economic regulation. If you are responsible as a financial regulator for controlling the stock exchange and financial institutions, the one thing you want is the capital market to work well and to be properly responsive to various stimuli and to be efficient in assembling the information—that's all economic regulation. But as soon as you say, "Well I care about fraud control or misrepresentation of profitability or manipulation of stock prices,"

those are specific forms of non-compliance, specific risks to investors and that almost fits in the category of social regulation. Protecting consumers is normally a social regulatory function but you see how deeply mixed up it is and how the market works, it's pretty hard to separate sometimes. I can't really draw a clear distinction.

How should a regulator go about designing an effective regulatory programme? What are the critical principles and fundamentals that one should know?

That's a huge question. First of all, regulators have to be seriously invested in analysis in order to pick apart the risks so that they can find the vital components. That is a data-driven process. It requires analytic versatility, and open-mindedness to try new forms of analysis, look at other sources of information, and get multiple perspectives on a problem until you see it in a way that's clear and usually in a way that you haven't seen it before. That's sort of finding the pieces.

Second, once you've seen the pieces, you have to understand the discretion that goes into the design of tailor-made interventions. First of all, you've got to have the organisational fluidity to organise resources around this problem, and your staff have to know what freedom they have to invent new solutions. You need the senior management team to commit resources to a new solution. You need the authority to act as well as the ideas. Senior management needs to bring together creative planning with authority in order to get resources committed to a solution.

Then you need honest and rigorous evaluation focused on outcomes. Without that, you're dead. If you start a new programme and you haven't got a metric system that can show you whether the problem got better, you will never know whether you're making progress or not.

How do you measure effectiveness? What is a good indicator of an effective regulatory agency?

The important thing to recognise is that there are different kinds of work and they have different kinds of key indicators. If you're concerned with the functional expertise, the key indicators are about quality of that function.

The second type of work is processes. The key performance indicators around your core high-volume processes are about timeliness, efficiency, productivity customer satisfaction, low data-error rates, low error rates.

The key performance indicators on the risk-control front are quite different. They are about risks reduced.

Balanced Scorecard in a regulatory environment must recognise these different kinds of work with different indicators for each kind of work. If you try and say, "I'm going to measure my risk reduction responsibilities with customer satisfaction," boy, you just lost it.

In a networked government, an outcome is shared. Different agencies contribute towards a larger public good or national goal. How would you measure their contributions without getting too absorbed by the agency-specific objectives?

One of the characteristics of the risk reduction work is that you focus on the risks, not on the agencies. Because the risks are not neatly aligned, you do end up talking about how much this problem got better and you recognise the contributions of multiple agencies. So you're moving naturally into a domain where you're dealing with multi-agency collaboration.

People want to be able to prove causality and to attribute the outcome to different functions and methods. It's important to understand that you usually cannot divide an outcome between agencies.

Look at disease management. For a particular problem like diabetes, there is a whole cocktail of treatments. It might include surgery, diet, maintenance programmes and education. You've got seven or eight different things going on and what you do is organise the performance metrics around the disease: How good are we at treating this disease? You might be able to say as a hospital, "We have a 35% survival rate for this

disease." OK. Do you take your 35%, can we divide that between surgery and penicillin and rehabilitation? No. We've designed a cocktail which produces 35%. If you've got a different cocktail that would do 47%, you'd move to that cocktail. But the idea of dividing up the lives saved and saying, "So many of them were saved by the surgery and so many of them were saved by the rehabilitation," is sort of silly.

As agencies collaborate or even within an agency, as functions collaborate to solve a problem, you actually cannot divide the outcome between the functions. The rules that emerge are: You can now take credit for outcomes because you focused on a piece of the risk and you reduced it, but you have to share it with other agencies that contribute. The other piece of this rule is: If you want to hog credit as an agency, or as a function, it's going to be for outputs, not outcomes. Rarely can you hog credit for an important outcome, because you need multiple players for that.

From what I understand, there are systemic solutions for systemic risks. How do you institutionalise or replicate solutions, instead of having one-off events or strategic innovation?

People use the word 'systemic' in different ways. Usually what they mean is: "I want to be able to control this problem by changing something once, in a way that will stop it re-appearing." In other words, I want a long-term, lasting solution so that I don't have to keep allocating resources to the suppression of this problem.

When you're considering an action plan and management's job is to approve it or disprove it, one of the tests that they should apply is to ask the question: Is there a long-term component of this plan that allows us to withdraw resources from it without the problem re-appearing? If the answer's 'no', then this plan won't do. Often there is a short-term, highly-intensive period because it's a sudden intervention, but then there must be a long-term component that says: How can I get my people away from this without this thing growing back to the original size? If your answer was, "Flood the area with directed patrol, or do a huge amount of examination here" but that's all, then you know full well it will reappear the moment you stop. So that plan won't do. Now you're looking for something different, something structural, something technical or systemic.

What are your impressions of the way Singapore is thinking about regulation and about moving to the roles of facilitator and convenor? What advice do you have for us in moving our regulation agenda forward?

My impression is that there has been more focus here on reform of the rules than reform of the practice. I'd question whether reform of the rules will get you where you want to be. I've not seen any other country where that alone gets you to effective regulatory practice.

What is my advice for you moving forward? Think seriously about what else other than reform of the rules needs to be established: the structure of discretion, the kinds of objectives set, the kind of performance story that you demand, and ultimately what performance you want from your regulators. Don't imagine for a minute that changing the law determines what they will do. It doesn't.

In your lecture you denied being "pro-enforcement" but you are against "toothless tigers". Can you elaborate?

From what I read, I suspect that the stage that you're at is the search for broader methods of enforcement. That's perfectly reasonable and very healthy. The potential danger, that others have fallen into, is that you de-emphasise enforcement to the extent that you can't do it anymore. At that point, your enforcement folk will get demoralised.

They'll stop work or work half-pace or go slow, will leave, or find another job because they'll feel unappreciated. Then you lose your capacity to control a serious issue should it arise and that's a real, big danger. So by all means broaden the tool-kit, explore new methods, pick and choose them carefully but don't throw away any tool, certainly not enforcement: You'll need it someday.

Which countries can Singapore learn from considering our current stage of regulatory reform?

I wouldn't point you to particular countries. For different things there are different agencies. The financial services sector around the world is quite sophisticated. But I would rather you study epidemiology and the way they think or military intelligence and the way they do threat assessment or the medical profession and the way they think about disease management, and try and get that kind of analytic and scientific approach built into civilian regulation. That would be a remarkable accomplishment.

What's the most common problem in regulation?

There are no systems and machinery to drive this work. The assumption is that it just happens because it's natural. It doesn't.

This interview was conducted by Tan Soo San, a senior research fellow at IPD. ■