

Making the UK more successful through better regulation

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THE
GROWTH
COMMISSION

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successful through
better regulation**

The Growth Commission

The Growth Commission is a non-partisan group of international economists analysing public policy and regulatory proposals and how they will affect GDP per capita growth in the medium to long-term.

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The Growth Commission Report No 3

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Making the UK more successful through better regulation¹

The Growth Commission Report No 3

Introduction

This paper summarises a series of reports outlining the case for growth through better regulation. Their theme is that the potential economic gains from regulatory reform² in Western economies in terms of GDP per capita benefits, is on a much larger scale than has been previously considered likely based on the findings of earlier research.

This is partly because much of the previous subject matter on this topic has focused on specific segments of regulatory impact – the impact of regulation on cost. More recent analysis draws attention to the fact that regulation's biggest long term impact is likely to emerge from its influence on restricting competition and innovation, both of which have the potential to commit considerable long term economic damage, more than a mere cost increase.

This paper distinguishes between so-called 'arterial sectors' which have a pervasive impact on the economy though their influence on other sectors. The paper explores that the effects of problems caused by bad regulation in arterial sectors are multiplied because of their impacts not only on their own sectors, but also those on the other sectors, whereas the effects of problems from the rest of the economy are at least largely limited to their own sector.

¹ This report has been co-authored by the Growth Commission Co Chairmen, Shanker Singham and Douglas McWilliams but has benefitted considerably from discussion with the other Growth Commissioners.

² We deliberately use the phrase 'regulatory reform' rather than the more frequently used 'deregulation'. This is for two reasons. First, the word deregulation is associated in the public mind with the removal of consumer and workplace protections which are not in general the main likely subjects of pro-competitive regulatory reform. Secondly, some regulatory reforms of the pro-competitive type might in reality involve increased rather than reduced regulation to ensure competitive and innovative outcomes.

³ Driving prosperity through effective Competition Rod Sims, Chairman, Australian Competition and Consumer Commission (ACCC), The Meico Forum 2013 Mexico City

This paper finally investigates UK official government regulatory impact assessments to see how they measure up against modern approaches to measuring the cost of regulation and makes recommendations for how they could be improved.

The paper is published alongside and draws upon the Growth Commission's Second Report by Alden Abbott and Shanker Singham, 'The Impact of Regulation on Economic Growth', which examines recent research on the same subject mainly in North America and which reaches similar conclusions about the likely scale of the impact of regulatory reform.

Summary

Bad regulation imposes costs on economies that inhibit GDP growth

Although the cost impacts of regulation matter, the longer term hits on GDP growth from the impacts of bad regulation on competition and on innovation are likely to be even greater. Modern approaches to analysing the influence of regulation place more focus on these impacts.

OECD evidence shows that even a relatively small improvement in the quality of regulation can boost GDP by 5%, which is likely to multiply over the longer term. This is evident in countries like Australia and New Zealand, which have seen boosts to GDP of 20-25% over a 25year period associated with packages of regulatory reform. In the case of Australia, the impact of proactively ensuring that competition considerations play a majority part in its consideration of regulatory promulgation, spurred by its productivity commission, has had a significant impact on the Australian economy.³ The multiplier of the total GDP effect of regulatory reform has proved to be about five times the initial cost-based estimates of the benefits.



The six 'arterial sectors' that underpin much economic activity in most economies

We propose the concept of six arterial sectors which underpin and influence the majority of activity within most economies. These are land use planning, housing, transport, communications, finance and energy. Getting regulations right for each of these sectors creates potential gains for GDP per capita on a considerable scale because not only do they improve productivity in the sectors themselves, but also in the other sectors that depend on them. Input output data shows that intermediate expenditure on the products covered by these sectors in 2019 was £653.4 billion or 47% of all intermediate expenditure on products in the whole UK economy.⁴

The government measures the impact of regulatory costs but uses traditional methods that understate the total negative impact on the economy. Using measures that take into account competition and innovation effects, could multiply these impacts by as much as five times.

The UK government's own estimates suggest that new regulations imposed since 2015 have added £28.7 billion to costs (and in 2022 alone added £10 billion to costs) against cumulative government targets for a decrease of £19 billion in regulatory costs. So even under the government's own methods of evaluation, the costs added to business from regulation are substantial and increasing. Additionally, the government's own independent verification body has criticised the number of 'red rated' (i.e. not fit for purpose) regulatory impact studies for being issued too late to be taken into account during legislation.

If the multiplier estimated from the analysis of Australian regulatory reform is used, the official estimate of a £28.7 billion increase in regulatory costs from regulations imposed since 2015 alone, might in reality become a tangible negative regulatory impact of £143 billion or 6% of UK GDP.

⁴ Analysis for 2019 from Input Output figures (see Table 1 in this paper).

³ Driving prosperity through effective Competition Rod Sims, Chairman, Australian Competition and Consumer Commission (ACCC), The Meico Forum 2013 Mexico City

Regulatory promulgation receives remarkably little scrutiny in the UK. While there has been a series of executive orders in the U.S. starting with the Reagan administration that firmly embed cost benefit analysis, and impact on trade even in regulatory review, in the UK while impact assessments are done, it could be argued that their value is limited by their apparent lack of bite, and the scope of their coverage. Parliamentary scrutiny is even less rigorous, and incumbents are often able to overwhelm the voice of the party affected i.e. business owners and taxpayers. Such consumer voices as do exist tend to focus on health and safety and increases in regulatory burden, rather than consumer welfare as an economic concept.

If the UK is to return to rates of economic growth comparable with the past, better regulation needs to become a major policy theme. This means full quantification of regulatory impacts before policy is decided, which would mean a higher level of scrutiny of regulatory costs when any new regulation is imposed. The body for regulatory improvement needs to apply political pressure to scrutinise existing regulations and to ensure they are replaced by pro-competitive regulations. It means paying particular attention to the arterial sectors which impose over £650 billion of costs on the rest of the economy and where the benefits of regulatory reform are multiplied through their impacts on other sectors.

The gains from improved regulation are huge.



The theoretical background

Regulations are imposed on markets and firms for a variety of reasons. Some have little to do with economics and are imposed to meet social (defined broadly to include environmental and other equivalent requirements) or political objectives. Others are attempts to make markets work more efficiently such as competition and standards regulation. While in theory, meeting regulatory requirements impose costs insofar as they require firms to do things that they would not do unregulated, many are designed to reduce costs through encouraging cost reducing competition or through making standardisation easier.

Regulations can be designed to ease market entry but often impose (in some cases hidden) barriers to entry into markets, frequently through imposing regulatory costs. While in theory these might be equal for all market participants, in practice they often can only be amortised over a considerable scale of production which in itself will impose a barrier to entry for the market through excluding insurgent and low-scale producers. Other regulations can often act as barriers to entry such as licensing regimes that require previous experience. Baumol, in his classic work on contestable markets, defined barriers to entry as anything that requires an expenditure by a new entrant into an industry, but that imposes no equivalent cost upon an incumbent⁵.

Regulatory costs themselves can impose deadweight costs on an economy that need to be taken into account and compared with potential economic benefits. But if those costs in addition limit competition, and the entry of new firms into markets, their impact can get much larger, and far exceed the narrow deadweight losses.

⁵ William J. Baumol and Robert D. Willig Fixed Costs, Sunk Costs, Entry Barriers, and Sustainability of Monopoly, *The Quarterly Journal of Economics* Vol. 96, No. 3 (Aug. 1981), pp. 405-431

The impact of competition

⁶ https://www.economist.com-future/2018/07/20/why-is-vigorous-economic-competition-a-good-thing?utm_medium=cpc.adword.pd&utm_source=google&ppccampaignID=18156330227&ppcadID&utm_campaign=a.22brand_pmax&utm_content=conversion.direct-response.anonymous&gclid=EAlalQobChMI1PWv14nX-gAMVkJmftCh05JQebEAMYASAAEgKsxfD_BwE&gclsrc=aw.ds Economist July 20 2018

Although for much of the post-war period, competition was not seen as especially important for driving growth, the combination of sclerosis of large corporations, the changing structure of economies and emergence of new information means that economists now generally subscribe to the view that enhanced competition is important for economic growth. Brink Lindsey, an expert on competition at the Niskanen, Centre described the current consensus in an interview in *The Economist* in 2018⁶

“Today, there is a robust consensus among economists that rivalry between firms is an essential precondition of a dynamic, innovative-market economy. A wealth of studies looking at the micro level assess what happens when firms are subjected to some sort of unexpected shock—say, the removal of trade barriers, leading to higher import competition. Those enterprises that suffer the shock also see higher productivity growth. The evidence is really overwhelming that having the wolf at your door, looking at the gallows, all of that concentrates the mind wonderfully.

“Larger-scale studies, meanwhile, find negative effects when product markets are tightly regulated. These negative effects include lower productivity growth and GDP growth. One thing to point out is that these losses seem especially large in poorer countries. Allowing firms in poor countries to freely adopt the technologies and labour practices of richer countries can lead to really rapid economic growth”.



The interview quoted above mentions innovation.

Economic theory is ambivalent about whether competition enhances innovation - while it is generally accepted that low levels of competition reduce innovation, it has often been argued that excessive competition denudes corporations of funds to invest in innovation and reduce the returns to scale that can reward these activities. The current conventional theory is that the relationship between competition and innovation is 'an inverted U' with a sweet spot with enough competition to boost innovation but not so much that it is inhibited.⁷

However, even the authors of this theory point to the fact that most empirical studies show a positive relationship between competition and innovation claiming: 'Theories of industrial organisation typically predict that innovation should decline with competition while empirical work finds that it increases', citing research by Geroski⁸, Nickell⁹, and Blundell, Griffith, and Van Reenen.¹⁰ However, to the extent that barriers to entry from regulation inhibit competition, it is not implausible to assume that these are likely to keep competition at a level well below the 'sweet spot' which maximises innovation. The impact of barriers to entry on innovation is not confined to the competition impact alone. The Schumpeterian theory of innovation¹¹ is based on inefficient firms using older technologies being replaced by newer more efficient firms using more innovative technologies. So to the extent that such barriers inhibit such 'creative destruction' it also inhibits the replacement of old technologies with new. Another way to look at the interaction between competition and innovation is to measure competition as a function of productive and allocative efficiency maximisation. This has been the approach adopted by Singham and Abbott.¹² Although it is certainly true that "cannibalistic" competition associated with attempts to fragment markets for fragmentation's sake can lead to significant productive inefficiencies which in turn limit innovation and thus GDP growth, empirical studies suggest this is generally more a theoretical problem than a real one.

⁷ Competition and Innovation: An Inverted-U Relationship Author(s): Philippe Aghion, Nick Bloom, Richard Blundell, Rachel Griffith and Peter Howitt Source: *The Quarterly Journal of Economics*, Vol. 120, No. 2 (May, 2005), pp. 701-728

⁸ Geroski, Paul, *Market Structure, Corporate Performance and Innovative Activity* (Oxford, UK: Oxford University Press, 1995)

⁹ Nickell, Steven, "Competition and Corporate Performance," *Journal of Political Economy*, (1996), 724-746.

¹⁰ Blundell, Richard, Rachel Griffith, and John Van Reenen, "Market Share, Market Value and Innovation in a Panel of British Manufacturing Firms" *Review of Economic Studies*, (1999), 529-554.

¹¹ Schumpeter, J.A., 1911. *Theorie Der Wirtschaftlichen Entwicklung*. Duncker & Humblot, Leipzig

¹² *Trade, Competition and Domestic Regulation*, Shanker A Singham and Alden Abbott (Routledge 2023)

The traditional approach to measuring the impact of regulation

The more traditional analysis of the impact of regulation is reflected in the 2018 OECD study¹³ constructing an index of product market regulation and relating it to GDP.

Even this analysis shows a larger impact from regulation on GDP than many might expect - Figure 1 shows that a reduction of only 20% in the index of product market regulation will generate a 5% boost to GDP after 20 years with the biggest part of the boost coming between years 10 and 20.

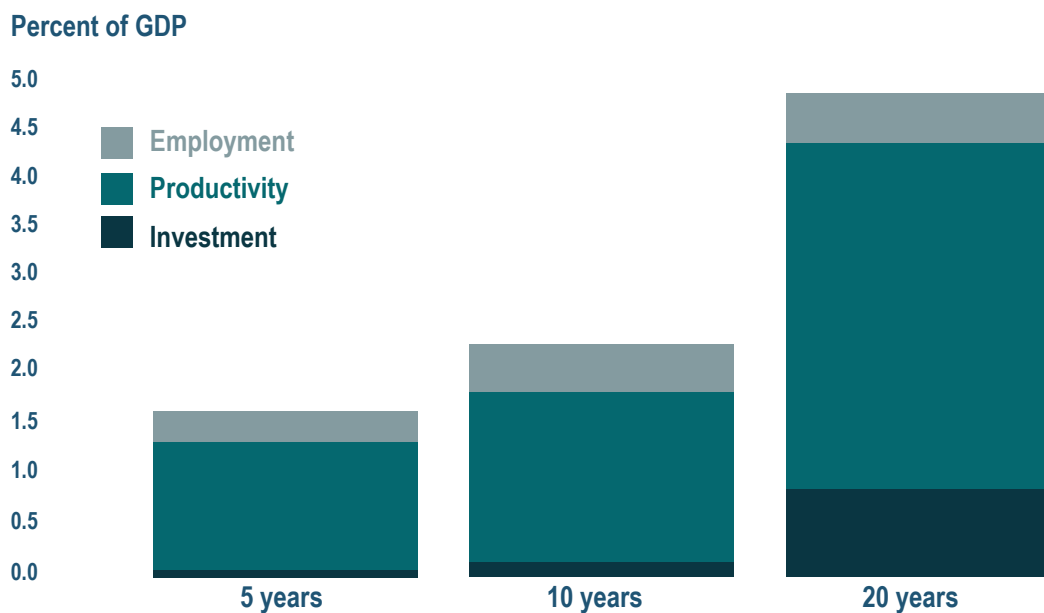


Figure 1 OECD study of impact of 20% increase in product market competition on GDP

Percent impact on total GDP of a 20 percent reduction in the value of the OECD Economy-wide PMR indicator broken down into the main channels that lead to the GDP increase.

Source: OECD analysis based on the quantification methodology developed in Egert, B. and P. Gal (2017), "The quantification of structural reforms in OECD countries: A new framework", OECD Reconomics Department Working Papers, No. 1354, OECD Publishing, Paris OECD 2013 PMR database.



Attempts to incorporate competitive effects in the measurement of regulatory impact

One early attempt in 2004 to quantify the impact of regulation on GDP in Europe taking into account competitive effects was by Klapper, Laeven and Rajan¹⁴ which concluded that on average barriers to entry in setting up new firms in Europe cost 10% of GDP. The paper showed that:

1. The rate of new corporation creation is lower in “naturally high barriers to entry” industries than in other industries. Some barriers to entry are more “natural” than others, such as extreme economies of scale, natural monopolies, and high start-up costs. Regulations are part of the barriers to entry, and they too should be expected to slow business creation. Across nations, the evidence is that the greater a nation’s high-entry costs, including regulations, the slower the rate of corporation creation in the nation, suggesting that these costs matter. Interestingly, they matter most in richer countries, or countries that are not corrupt, where the regulations on the books are more likely to be enforced.

2. Higher regulatory barriers restrict competition and innovation in part by making it harder for more innovative new businesses to break into an established industry, thus reducing innovation in the industry. The growth in value added per employee for firms older than two years is relatively lower in naturally high-entry industries when the industry is in a country with higher bureaucratic barriers to entry, consistent with the hypothesis that entry regulations indiscriminately screen out small young firms and inhibit the disciplinary effects of competition.

3. Higher regulatory barriers are also found to slow the rate of innovation among the older firms in a high barrier to entry cost industry. Costly entry regulations are a form of protection that has the economically deleterious effect of reducing the competitive need for, and slowing the adoption, of innovation by seasoned incumbents.

¹⁴ Entry regulation as a barrier to entrepreneurship Leora Klapper Luc Laeven Raghuram Rajan Working Paper 10380 <http://www.nber.org/papers/ March.2004>

¹⁵ Singla, Shikhar, "Regulatory Costs and Market Power." LawFin Working Paper No. 47, Center for Advanced Studies on the Foundations of Law and Finance, Goethe University, February 23, 2023.

¹⁶ McKinsey Global Institute Driving productivity and growth in the UK economy October 1, 1998 | Report

¹⁷ Land Use Regulation as a Barrier to Entry: Evidence from the Texas Lodging Industry Junichi Suzuki University of Toronto January 23, 2013

¹⁸ Fredrik Erixon Oscar Guinea Philipp Lamprecht Elena Sisto Erik van der Marel 'The Economic Dividend of Competitiveness' ECIPE March 2023

Singla,¹⁵ in a fascinating study in the US (also referred to in the accompanying paper) concluded that there had been a \$1 trillion increase in the Federal regulatory burden on companies between 2007-18 and that this had been associated with between 31 and 37% of the increase in the market power of incumbents.

An even earlier study was that commissioned from the McKinsey Global Institute¹⁶ by the incoming Labour government in the UK in 1997. This looked at a range of industries. One of its key themes was the importance of land use planning especially for two of the industries studied.

The study argued that 'the primary reason (for low productivity in UK food retailing) is that land use and planning regulations make it difficult for large format operators to develop new sites or expand existing ones'. And that 'Strict building codes have prevented the development of a competitive hotel industry' leading to building or refurbishing costs 40% higher than in the US and moving the breakeven for UK hotels to 80% occupancy compared with 50% in the US. The conclusions about the impact of regulation on the hotel industry have been backed up by an entirely separate study of hotels in Texas by Suzuki¹⁷ which concludes: 'According to my estimates, the change in the stringency of land use regulation from the sample first quartile level to the sample third quartile level increases the level of the market specific operating cost by 5.4 percent and that of sunk-entry cost by 24 percent, respectively. As a result, the revenue-per-room, a proxy for the price, increases by 12 percent'.

The McKinsey study blamed the bulk of the comparative inefficiency (UK productivity about 50-60% of that in comparable economies) of both sectors on planning and other regulations.

More recently, detailed research has been carried out by the European Centre for International Political Economy (ECIPE)¹⁸ on how the European economy might look if five specific regulatory changes took place.



The conclusions of the research are:

1. Dynamic markets: markets with a significant number of competitors and low market barriers are more likely to deliver new innovation and ultimately productivity growth. Achieving the policies set out in this scenario would increase EU GDP by 1.2%.
2. A thriving services industry: a growing number of technologies will be developed outside the EU and will be transferred through services, making trade in services a crucial input for EU competitiveness. Achieving the policies set out in this scenario would increase EU GDP by 0.3%.
3. Openness to digital trade: many of the latest and most promising technologies will have digital inputs or will be delivered through the Internet. Therefore, the growth of the digital economy will be a prime force for new patterns of productivity and trade. Achieving the policies set out in this scenario would increase EU GDP by 0.1%.
4. A globally integrated economy: supporting global free trade is essential for raising competitiveness. Access to cheaper inputs and more customers abroad make firms more competitive and economies more specialised. Achieving the policies set out in this scenario would increase EU GDP by 1.1%.
5. A knowledge-based economy: innovation is at the heart of productivity growth and competitiveness. It creates new markets and increases economic efficiency while it supports knowledge spillovers that lead to higher economic growth. Achieving the policies set out in this scenario would increase EU GDP by 0.1 percent in the short-term and 0.3% in the long-term.

¹⁹ Driving prosperity through effective Competition Rod Sims, Chairman, Australian Competition and Consumer Commission (ACCC), The Mexico Forum 2013 Mexico City

²⁰ Data for Australia and New Zealand from OECD Economic Outlook Statistical Annex June 2023

The total assessed impacts of introducing these reforms alone would be a boost to the EU economy of 2.95% in five years alone. It is worth noting that most studies of the impact of regulatory reform suggest that their main knock-on effect after 20 years is substantially greater than the 5-year impact. One might expect 'a priori' that this would be especially the case when investigating competitive and innovation effects since such effects take time to affect economies.

The two OECD countries for which there is most empirical evidence of the impact of pro-competitive regulatory reform are Australia and New Zealand. The Chairman of the Australian Competition and Consumer commission has described the impact of this pro-competitive regulatory reform in Australia.¹⁹ His description compares the ex-ante assessed impact and then the actual impact of the National Competition Policy introduced in Australia by the then Labor Government under Paul Keating from 1992-1995. These policies were forecast to raise GDP within 5 years by 5.5%. The actual post event assessment shows the Australian rate of growth changing from slightly below the OECD average from 1975-91 before the policy reforms were introduced to a consistent rate of growth of 0.9% faster than the OECD average, both from 1997-2007 and from 2008-2022. Post reforms the cumulative excess growth record to 2022 has been 24.8%. While it would be an extreme assumption that all this excess growth is attributable to the policy reform, the faster growth following the reforms is impressive.

Economic reform in New Zealand (also imposed by a Labour government) has also been associated with faster economic growth – an economy that pre the 1970s had largely kept pace with Australia, fell back relatively both before and in the immediate aftermath of the implementation of the reforms but has also grown significantly faster since 1997 at 0.8% faster than the OECD average generating cumulative excess growth over the period of 22.4%.²⁰



The evidence from these countries suggests two conclusions:

First, it is likely that the conventional measures of the impacts of regulation which focus on costs alone will understate the total impact if they ignore the impacts on barriers to entry, entrepreneurialism, competition and innovation. Whereas cost based estimates rarely generate estimated GDP losses from feasible regulation reforms much above 5%, the competition and innovation based estimates hint at impacts that could be as large as 25%. So the scale of the total benefits from better regulation could be as much as five times the initial cost based estimates of the benefits. Second, it is quite likely that the long term impacts are a considerable multiple of the short term (i.e. 5 year) impacts as the full effects work through.

We would recommend that studies of potential regulatory impacts should take into account a much wider range of potential impacts than cost alone.

Arterial economic sectors

The Economist has described some infrastructural sectors as 'economic arteries and veins'.²¹ The classic McKinsey analysis of economies makes the same distinction between these sectors and others. In the context of regulation, we have identified 6 sectors of special importance: land use planning, housing, transport and communications, finance and energy. These sectors all have knock-on implications for the rest of the economy in different ways:

²¹ Essential Economics Matthew Bishop The Economist 2004 p167

1. Land use planning has already been identified in this paper as a factor affecting a range of sectors and in particular retail and hotels. But in fact its impacts are more pervasive since planning affects any activity that requires premises. (sector A in Table 1)
2. Housing has a major impact on the cost of living and hence wages. It also affects labour mobility and hence the flexibility of the economy. (sector B in Table 1)
3. Transport and communications strongly affect companies' ability to do business in a range of ways. If anything it would appear that the relative importance of communications is especially increasing. They also impact on competition because lack of transport or communications links can permit the emergence of local monopolies. (sector C in Table 1)
4. Finance is central to any economy through its ability to recycle savings into investment, to monetise business success and to provide flexibility for businesses. Access to a competitive financial sector is important to enable new entrants to challenge incumbents in markets. (sector D in Table 1)
5. Particularly in a climate of 'net zero' ambitions, access to cheap, easily available and clean energy is a particular competitive advantage, especially for manufacturing sectors and increasingly for technological sectors. (sector E in Table 1)



Table 1 Latest UK input output data on intermediate use of products by other sector.
Figures measure total intermediate consumption of each product category.

	£ millions	Sector
Other professional, scientific and technical services	22,444	C, D
Services of head offices; management consulting services	22,707	
Wholesale and retail trade and repair services of motor vehicles and motorcycles	23,504	C
Rental and leasing services	23,544	
Education services	25,484	
Legal services	25,581	D
Retail trade services, except of motor vehicles and motorcycles	25,787	
Gas; distribution of gaseous fuels through mains; steam and air conditioning supply	28,927	E
Architectural and engineering services; technical testing and analysis	29,028	A
Warehousing and support services for transportation	32,440	C
Advertising and market research services	36,641	
Land transport services and transport services via pipelines, excluding rail transport	39,884	C
Employment services	45,697	
Real estate services, excluding on a fee or contract basis and imputed	48,361	A, B
Services auxiliary to financial services and insurance services	49,601	D
Computer programming, consultancy and related services	54,827	C
Electricity, transmission and distribution	65,039	E
Financial services, except insurance and pension funding	77,354	D
Wholesale trade services, except of motor vehicles and motorcycles	87,343	
Construction	156,437	A, B

These arterial sectors need to be especially well regulated because the form of regulation does not just affect the sectors themselves but also the other sectors that depend on them.

Table 1 takes data from the latest UK input output tables²² to show the dependence of other sectors on them. It lists the intermediate consumption of the products by other sectors, and shows the extent of purchases of these products at basic prices in 2019. It shows how important these arterial sectors are in driving the rest of the economy and so how important it is to ensure that they are competitive and innovative.

²² <https://www.ons.gov.uk/economy/nationalaccounts/supplyandusetables/datasets/ukinputoutputanalyticaltables/detailed>

²³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916918/better-regulation-guidance.pdf

²⁴ <https://www.gov.uk/government/publications/rpc-independent-verification-body-report-december-2021-to-december-2022>

²⁵ As in note 24

In 2019 these sectors contributed £653.4 billion in costs to other sectors of the economy. This compares with a total of products and services purchased by those sectors of £1,388,8 billion – so 47% of the total purchases of products and services. Since many infrastructural services (e.g. roads) are provided free or are subsidised (e.g. rail), even this measure will understate the importance of arterial sectors to the economy.

Official regulatory impact reports

Both of the authors of this paper have been proponents of regulatory impact assessments. When working for the Confederation of British Industry (CBI) and as chairman of the economics committee of what is now called Business Europe, Douglas McWilliams was a key promoter of the UK and EU introducing regulatory impact assessments that are carried out by governments. Shanker Singham has been deeply involved in efforts in the OECD and ICN to improve regulatory promulgation and take proper account of competition effects.

We have examined directly a small sample of official regulatory impact reports (see Annex 1) and have examined the reports of the official verification body that oversees these reports. There are guidelines for ‘better regulation’²³ and an ongoing review to improve the quality of regulation. There is an independent verification body with some distinguished members which reports annually.²⁴ The independent verification body is concerned that despite an objective of keeping the regulatory costs on business constant, the regulatory assessments that it covered over the year from December 2021 to December 2020 would increase the costs on business by £9,893.8 million.

Figure 2 below is the extract of paragraph 7 of the most recent independent verification report²⁵ showing that the assessed regulatory burden is growing at an increasing pace. Moreover the report expresses concern that the number of red-rated (i.e. unsatisfactory) assessments is increasing and that many are submitted late and after parliamentary consideration of the relevant legislation. Finally the verification report has drawn attention to the lack of ex-post scrutiny of cost assessments.



What is clear is that there is a disconnect between the government's persistent objectives of reducing or at least holding steady the regulatory burden and its actual performance, although it does appear that there are parts of government that take regulatory assessments very seriously (see scrutiny of government impact assessments)²⁶.

The independent overseeing body has pointed this disconnect out as it has the red rated assessments and those that are too late.

The Better Regulation Framework allows the RPC (Regulatory Policy Committee) to issue an opinion that an IA (Impact Assessment) is "not fit for purpose" where it has sufficient concerns with the calculation of the EANDCB (Equivalent Annual Net Direct Cost to Business) figure and/or the small and micro business assessment. Where timescales allow, we issue an "initial review notice" (IRN), which allows the department to revise the IA and re-submit it. In most cases this then results in a final 'fit for purpose' opinion. We issued IRNs in relation to IAs as first submitted for three of the 24 measures that contributed to the total BIT (Business Impact Target) score across the period of this report. Even with the IRN process, there has been a concerning increase in the number of IAs that we have red-rated this year. Between 2016 and 2020 we did not publish any red rated opinions. Since 2021 we have published eight red-rated opinions, including four in 2022 and two (so far) in 2023²⁷.

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While there are Impact Assessments, there has been limited review of regulations from a competition perspective. While business compliance costs are considered as noted above, the problem with anti-competitive regulation is not the effect on business but the effect on the wider economy as seen in GDP per capita measurements. As noted in Growth Commission paper 2, there is even less parliamentary scrutiny of proposed regulations, and incumbents tend to exert significant control over parliamentary processes having a much louder and more concentrated voice than the generalised consumer interest.

A full competition assessment to consider the anti-competitive effects of new regulation and therefore its impact on the wider economy (as opposed to just business compliance cost) is rarely if ever undertaken, and where it is done it is largely ignored by policymakers.

²⁶ <https://rpc.blog.gov.uk/2021/12/17/scrutiny-of-government-impact-assessments/>

²⁷ As in note 26. Authors' insertions in italics

There are areas where the Competition and Markets Authority (CMA) does consider how competition is working in a particular sector but it often stops short of any meaningful recommendations for fear of treading on the toes of other regulators (an example is the CMA's analysis of financial markets which hesitated to make recommendations for fear of the reaction of the Bank of England).²⁸ Yet, both the OECD and International Competition Network have long argued for that the competition effects of regulation to be fully accounted for prior to regulatory promulgation.²⁹

7. The Table below shows the change in business impacts compared to the Government's BIT target since the current regime was introduced in 2015.

	2015 Parliament*	2017 Parliament*	2019 Parliament*
BIT Target	£10bn reduction	£9bn reduction	£0 'holding' target
Interim Target	£5bn reduction	£4.5bn reduction	£0 'holding' target
BIT Outcome	£6.6bn reduction	£7.8bn reduction	£14.3bn increase*

* The 2015 and 2017 Parliaments ran for shorter periods than the five years for which the BIT was set. The three-year interim may be more appropriate for comparison with outturns.
* Cumulative outcome for Dec 2019 to Dec 2022 (excluding temporary Covid measures).

Figure 2 Comparison of sessed regulatory burden with government targets

Moreover, the actual assessments seem to focus entirely on regulatory costs with no attention at all paid to the longer term costs of lack of competition or innovation. Despite this, as Figure 2 shows, the verification body has shown that a cumulative government target of reducing the regulatory cost burden of £19 billion since 2015 has resulted in a regulatory cost increase of £28.7 billion.³⁰

If the multiplier based on Australian and New Zealand evidence that the total negative impact of regulation on an economy is about five times the impact measured by simply measuring regulatory costs, this might imply that new regulations imposed since 2015 have cost the economy £143 billion. This is about 6% of GDP.³¹

Even though many of the relevant items of analysis are missing, since little attention is paid to the analysis which already exists, it is hard but to conclude that both the government and parliament do not seem especially interested in trying to improve the quality of regulation.

²⁸ Competition and Markets Authority, Retail Banking Markets Investigation (2016) available at Retail banking market investigation - GOV. UK (www.gov.uk)

²⁹ OECD Competition Assessment toolkit available at Competition Assessment Toolkit - OECD and ICN Competition Advocacy working group on competition assessment available at Competition Assessment - ICN (international-competitionnetwork.org)

³⁰ This figure emerges from adding the numbers in Figure 2. It is likely that the earlier estimates were made using earlier price bases so in practice this total will underestimate the total increase in cost burden at current prices.

³¹ One should be careful not to imply that GDP in a particular year would have been 6% higher without this regulation, since the official assessments of regulatory cost are generally NPVs rather than running annual impacts.



Conclusion

The initial hypothesis of the authors is that the quality of regulation matters.

It is not an optional extra and the notion that in developed countries the quality of regulation is adequate is not supported by the facts. The evidence from the various studies put forward here suggests that a considerable proportion of the decline in growth of GDP per capita that has taken place in the UK since the 1980s is likely to be attributable to bad regulation that has damaged competition and preserved incumbent advantage. Such regulation also increases the size of the administrative state which manages the regulatory system, and consists of the incumbent firm and its advisors (lawyers, bankers, accountants) all of whom actively lobby for increased regulation to keep out competitors and for whom the status quo must be preserved at all costs.

Our thesis is that regulation matters in all sectors, but matters especially in what we call the arterial sectors which have more pervasive impacts on the rest of the economy. Bad regulation in these sectors has an impact on not only productivity and competitiveness in the sectors themselves but also, through the excess costs they impose, on others.

If the decline in the UK's growth in GDP per capita is to be reversed, it is vital that the quality of regulation improves, and we will need better ways of delivering the OECD's Competition Assessment and Regulatory Toolkit by including effect on markets (in terms of both competition and trade effects) in the cost benefit analysis for regulatory promulgation. Countries need to then pay attention to these effects. Too often, to the extent that such impact assessments are made, they are ignored by the relevant authorities.

The Growth Commission is developing better models to assess the total impact of bad regulation. But without more attention being paid to the full economic impact of regulation, it is likely that regulations will continue to impose major costs on the UK economy.

³² https://www.legislation.gov.uk/ukia/2023/89/pdfs/ukia_20230089_en.pdf

³³ https://www.legislation.gov.uk/ukia/2023/90/pdfs/ukia_20230090_en.pdf

³⁴ https://www.legislation.gov.uk/ukia/2023/91/pdfs/ukia_20230091_en.pdf

Annex 1

We have looked closely at the three most recent official regulatory impact assessments in this area at time of writing (early August 2023) to understand in more detail how the government in reality assesses the impacts of regulation.

They are:

1. Pensions Dashboards Impact Assessment (2023 amending regulations)³² This concluded that the £620 million of costs to business would be associated with a total net social gain of £174 million. This gain only emerges because the whole value of ‘lost pension pots recovered’ attributable to the dashboard is given an NPV of £776 million. It appears that there is no allowance made for the fact that such pots – if the pensions remain unclaimed – are distributed to ‘good’ causes. The analysis does refer to likely consolidation of the pensions industry but does not attribute any cost to this, suggesting that even these numbers are underestimates.

2. Tourism: The Grading Inspection of Certified Tourist Establishments (Fees) Regulations (Northern Ireland)³³ 2023. This is a voluntary scheme for grading tourist establishments on a fee-paying basis. The cost of the scheme is estimated to be £67,500 a year. No estimate is made of the benefits or the competitive impact. Given that the scheme is voluntary, one must assume that those participating in it believe their costs are outweighed by the benefits. Competitive impacts will be minor and possibly positive.

3. GB Insulation Scheme (formerly ECO+) Final IA.³⁴ This is a rather more thorough assessment than the previous two, using detailed cost benefit analysis. The report comprises 51 pages. The net present value of the costs (discounting back to 2023 but at 2022 prices) is £930 million; the assessed value of the benefits is £1,730 millions generating a ratio of benefits to costs of 1.89. It should be noted that the 56% of the benefits are the assessed benefits of reduced greenhouse gas emissions, where the shadow price used for valuing the reduction in emissions is provided by a calculation of the price needed to reach the policy objective of net zero by 2050 –



this is about five times higher than the price that might be calculated using the Stern Review approach. There is no discussion of the impact of the costs on market structure or on overall energy costs. The Growth Commission will be looking at specific regulatory systems in arterial sectors such as energy to identify the costs to the wider economy in terms of GDP per capita of regulations.

We also look at one area where the government has not published a regulatory assessment despite its statutory obligation to do so before legislation is passed.

This is the ban on sales of internal combustion engined cars from 2030. This was announced in a Department of Transport Press Release in November 2020³⁵ though legislation to implement this has not yet been introduced. The economics consultancy Cebr³⁶ has published an assessment for FairFuel UK using official techniques and values by a former Department of Transport head of assessment showing that the direct costs of this ban are five times the benefits. There has been no official response to this analysis. Moreover we do not find that the costs to the wider economy have been considered in this decision making process.

Our preliminary conclusion from these assessments is that although the government attempts to fulfil its obligation to produce such assessments, they seem to be prepared at a late stage when policy has been decided, they are not carried out to a very high standard and seem treated as optional extras and not as intrinsic to decisions on whether policy should proceed. This is far from the original intention of those who promoted the policy of regulatory impact assessments.

³⁵ <https://www.gov.uk/government/news/government-takes-historic-step-towards-net-zero-with-end-of-sale-of-new-petrol-and-diesel-cars-by-2030>

³⁶ One of the co authors of this paper, Douglas McWilliams, is founder and deputy chairman of Cebr and was involved in the Cebr assessment.



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