
THE REGULATED ECONOMY

Economic Monitoring Group

New Zealand Planning Council Monitoring Report

THE REGULATED ECONOMY

25 August 1985

MEMBERS OF
THE ECONOMIC MONITORING GROUP

The Chairman
New Zealand Planning Council
WELLINGTON

G.R. Hawke (Convener)
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Secretary
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WELLINGTON

Economic Monitoring Group

This report, published by the New Zealand Planning Council, was prepared independently by the Economic Monitoring Group. The views expressed are the sole responsibility of the Economic Monitoring Group and are not necessarily endorsed by the Planning Council.

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26 August 1985

The Chairman,
New Zealand Planning Council,
WELLINGTON.

Dear Mr Douglas,

I have pleasure in forwarding to you the fifth report of the reconstituted Economic Monitoring Group, which in accordance with the independent right to publish that the Planning Council has given the group, will be released soon.

Yours sincerely,



G.R. Hawke
Convenor
Economic Monitoring Group

MEMBERS OF
THE ECONOMIC MONITORING GROUP

G.P. Hawke (Convener)
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28 August 1981

The Chairman
New Zealand Planning Council
WELLINGTON

Dear Mr. Hawke

I have pleasure in forwarding to you the minutes of the reconstituted Economic Monitoring Group, which in accordance with the agreement reached at the Planning Council has given the group, will be released soon.

Yours sincerely

G.P. Hawke

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Examples of each of these are discussed, showing the issues around the regulation of each, and where possible, alternative approaches to the problem are suggested. The regulations are appended to each.

It is a common view that government intervention is justified where market failure is present. It is important to note that market failure is not a sufficient condition for government intervention. It is also necessary that government intervention be justified on other grounds.

1. provide a public good
2. provide a natural resource
3. provide a natural resource
4. provide a natural resource
5. enforce a moral judgment

However, the economic justification of these categories are not mutually exclusive. It is possible that a single regulation may be justified on more than one of these grounds. For example, a regulation that provides a public good may also be justified on the grounds of providing a natural resource.

The Economic Monitoring Group was established in 1977 to provide a forum for discussion of economic issues. It was reconstituted in 1981. The group's terms of reference are to provide a forum for discussion of economic issues, and to advise the Government on economic matters.

The group's work is divided into two main areas: the analysis of economic issues, and the provision of advice to the Government. The group's work is also divided into two main areas: the analysis of economic issues, and the provision of advice to the Government.

The Argument

In a modern society such as New Zealand, government intervention in the economy is inevitable. It is important that intervention be well designed to achieve its purpose and to avoid unwarranted costs to other activities, especially at this time as we attempt to reverse our recent failure to achieve our economic objectives.

Within this general field, intervention in the form of regulation needs attention. Regulation is thought of in terms of isolated occurrences rather than in general ones, but the central thread to it is the imposition of decisions about resource allocation by command. It is a matter of degree, measured by the extent to which government specifies in detail what would otherwise be left to the decision of market participants, consumers as well as producers. The central economic questions about it are:

1. the effects which commands over resource allocation have on economic efficiency;
2. the equity of the resulting gains to some groups and the losses to others; and
3. the desirability or otherwise of the impediments which are created by adjusting to economic change.

This report is an exploratory one. It looks at the extent of regulation in New Zealand, summarising a large file which has been constructed from central government legislation, both Acts of Parliament and subsidiary instruments. The actions of other government agencies and of local bodies have generally been excluded at this stage. Even so, a very large body of material is covered and it has been classified into 12 ways in which market behaviour has been constrained:

1. Prices are fixed or controlled.
2. Entry of new investment is restricted.
3. Entry into occupations is restricted.
4. Labour inputs are subject to conditions.
5. Land and other natural resource use is regulated.
6. Financial resources are regulated.
7. Other inputs and processes are subject to control.
8. Product quotas are set.
9. Product quality is specified.
10. Information requirements are prescribed.
11. Service conditions are specified.
12. Provision is made to collect industry levies.

Examples of each of these are discussed, showing the issues around the reasons for regulation and where possible, alternative approaches to the problems with which the regulations are intended to deal.

It becomes clear that it is not possible or sensible to form a view for or against "regulation". It is possible to generalise and say that most regulation can be classified as intended to:

1. promote some economic objective, or
2. protect personal safety or health, or
3. protect the environment, or
4. provide a means for distributing some public goods for which the market is deemed inappropriate, or
5. enforce a moral judgement.

However, the economic and social implications of these categories are intermingled, and decisions about both the intentions of regulations and the means of realising them have to be sought at a more detailed level. This requires the skills of a wider group than professional economists and should be the subject of public debate. Furthermore, there is a need for more economic knowledge than is available at present, especially about the extent and significance of the impact of regulation.

The Economic Monitoring Group therefore concludes that continued discussion should be about regulatory reform rather than about deregulation. It recommends that we should look again at the use of "sunset" clauses so that regulations expire unless there is a definite decision to renew them. We need some mechanism to ensure that regulations do not continue when changes in the economy or in society have made them inappropriate. We need to scrutinise especially carefully those regulations whose original purpose has been served but which continue to be in the interests of people intimately concerned with them at the cost of others less aware of their existence and impact.

Legislative reform requires resources, and on its own it is unlikely to have sufficient momentum to keep those resources against pressures to deal with issues which seem to have more immediate significance. The Monitoring Group therefore favours some kind of review process. This could take the form of a "transparency agency" or "regulatory review authority". Ideally such a body would act as a forum at which those advocating regulatory intervention would have to justify their claims in the face of scrutiny by groups who are adversely affected and by the economy and society at large. The body's staff could also initiate reviews of existing regulations as well as overseeing new regulation. The file of material accumulated for this exploratory report would be available to such a body, as it is to any individuals interested in exploring the field further.

Government Intervention

Coercive Power

Most people readily accept that government is a necessary and desirable institution in a society such as ours. Arrangements for production, distribution and social organisation are complicated. There are many groups within the population that take on different functions. They mingle with reasonably explicit notions of national, regional and cultural identity. The idea that power should somehow be concentrated to facilitate rule-fixing naturally follows. The system of parliamentary democracy imposes recognisable constraints on the use of this power.

Despite the checks and balances, there is a strong element of coercion in the functions of government. It would be something of a miracle if nobody disagreed with the rules, or felt adversely affected by them. However, controversy hinges mostly on what the rules should be, rather than whether there should be rules at all.

There are, therefore, grounds for much debate regarding exactly what should be influenced by government and how that influence should be exerted. Major interests in society see government as an institution which can do worthwhile things, and actively encourage it to do so. The outcome can often be controversial, and can lead to intense activity by organised groups to change the way in which coercive and other powers are used. This can be a very important element in determining the shape of government intervention, and will be explored in more depth later in the report.

Any use of government authority has the potential to affect the use of resources, and there are likely to be significant (good or bad) economic effects. All aspects of government activity warrant examination in this respect. This is true whether the policy action is focused on economic goals or on quite different objectives such as social equity, national security, international relations, or the definition of the rights of individuals and groups. Indirect and unintended economic effects are likely to play an important role.

Although a wide-ranging and complex legal system necessarily underpins modern society, it is fair to say that we live in an age in which it is widely thought that government over-legislates in many areas. Nowhere is this sentiment more evident than in the economic sphere. The Economic Monitoring Group itself has been critical of intervention in the New Zealand economy in recent years, arguing that

it probably contributed to our failure to attain economic objectives. The Monitoring Group argued that policies adopted to ameliorate adverse influences clouded important signals about market trends and retarded desirable adjustment. Its policy recommendations have included removing barriers to entrepreneurial initiative. Other commentators have put even more emphasis on that concern.

It would seem to be important to give serious attention to the way in which regulation comes about, and in particular, to bear in mind its historical elements. Very often rules will have been made in response to some past problem or circumstance. But circumstances change over time, as does the meaning or relevance of the rules, although the rules themselves alter little, if at all. There is continuing tension between the desire of those drafting legislation to use precise and certain language and the likelihood that the economy to which it applies will change over time. The evolution of economic structures around particular sets of rules probably goes a long way to explaining the ease with which losers are more easily recognised than winners in the face of proposed rule changes. The fact that the real meaning of the rules may have been lost sight of does not effectively reduce resistance to changing them.

Despite superficial impressions, therefore, any process of reform or abolition is extraordinarily difficult. In almost all circumstances, some vested interests will be damaged by legislative change. Even when the real effect of reform may be to open up fresh avenues for profitable enterprise, leaving everybody eventually better off, costs of adjustment have to be faced and these will be uppermost in the minds of those affected. There is a natural instinct to favour what is familiar and to avoid risk, and this adds up to a powerful body of influence resisting major change.

This report considers the regulation issue with a more specific focus. The subject, as has already been suggested, is a particularly difficult one with which to come to grips. The present objective is to provide an overview of the effects of the legal framework on the economy, and to point out some of the more important problems evident in the New Zealand system. In order to do this, an extensive analysis of existing legislation has been conducted from an economic perspective. To come to useful policy judgements, much more than this must be involved. Other professional disciplines and the wider public ought to contribute, as well as more economic research. Analysis, therefore, should be on-going.

Forms of Intervention

It is necessary to be more specific about identifying "regulation". The result of intervention, irrespective of the form it takes, is modification of the market outcome — prices, production, quality or the mix of inputs. Regulation is a particular form of intervention. Other forms of intervention involve the use of government budget measures and the government ownership of economic resources. As there are some overlapping features which create difficulties in putting particular policies in one group or the other, it will be helpful to discuss each of these briefly.

1. Regulation

Regulation defies adequate definition, but the most useful one the Monitoring Group has found is that of Pincus and Withers¹:

"... government commands having effects on resource allocation. The degree of regulation... depends on the extent to which government specifies in detail what would otherwise have been left to voluntary decision".

The element of compulsion and the reference to detailed conditioning of market outcomes are the primary ingredients of this description. The suggestion that regulation might be a matter of "degree" rather than an absolute concept (i.e. as opposed to the notion that something is either regulated or is not regulated), is also relevant. The salient question for policy reform in almost all cases will be, "What sort of regulation should we have?", rather than, "Should we have regulation?".

2. Government Budget Measures

The scale of government taxation and expenditure has major economic consequences. Included in this are subsidies and other expenditures or taxes which affect the relative competitiveness of industries in relation to each other. The power of government is used to transfer income to or from specified activities, often on a highly selective basis. Clearly the potential exists to provide highly favourable or unfavourable conditions to different interests as a result of budget choices. However, there is always a margin at which the subsidy or the tax ceases to provide absolute assistance or penalty, and operators are exposed to market conditions. This is the essential difference between regulation and the budget as tools of policy.

A moment's thought, however, suggests that budget decisions may embody rigidities which are distinctly regulatory in character. For a firm to qualify for a subsidy for example, it may be required to arrange its inputs in a certain way, to achieve a specified minimum level of output, or to fulfil some other condition. Therefore, although the essence of the policy is to do no more than change the margin at which normal

competitive forces operate, it is highly probable that firms would adjust the scale of output or make other adjustments in their enterprise for no other reason than to qualify for assistance. The element of command inherent in the notion of regulation as defined above is absent, but the "consumer" of government intervention may see the degree of choice as very limited. Often the effects of such interventions will be trivial, and it would confound the analysis to attempt to measure them. However, this will not always be so and significant structural consequences could ensue.

3. Government Trade Activities

The Government may intervene in the economy through the trading units which it owns and controls. In principle, public enterprises could operate like any other market participant, and private enterprises often declare their corporate objectives to be much wider than maximising output from the resources at their disposal. But most commentators would judge our recent experience to be that public enterprises have more often been asked to serve non-economic ends. Certainly, because of its collective power, the Government is able to finance losses and tolerate low profitability in ways not available to the private sector. The prices of government trading bodies may be affected by differences in objectives and in financial constraints, subject only to government's self-imposed restraints.

Such intervention is likely to be related to other government measures. The options for financing losses constitute a link with budget measures; in principle, it is just as easy for government to subsidise the private sector, but tolerating low returns from public bodies is less obvious than most other forms of subsidy. More significantly, some government trading activities are protected by restrictions on private sector operators imposed by regulation. The Post Office may be protected by restrictions on private couriers or on telecommunications businesses which compete or have the potential to compete. (In some cases, private businesses may also be protected by non-economic limitations placed on the Post Office or other public trading bodies.) Furthermore, there are many internal rules applying to public trading bodies. In some respects, they are no different from the internal regulations of private businesses; any organisation, whether operating in a market environment or any other kind, naturally devises and evolves working rules and guidelines and a command structure. But those of public bodies often have a statutory basis and can be enforced through the courts.

Why Regulation May Be Important

It remains to spell out more fully what the possible significance of studying the regulatory structure might be. Any particular piece of legislation is interesting for its own sake, but the Monitoring Group's concern is a wider one. There is clearly general concern about the per-

formance of the New Zealand economy, and in particular the low levels of sustainable growth that are possible with the present structure. It is in this context that regulatory policies are addressed.

The current economic debate has two recognisable themes:

- economic efficiency and equity
- adjustment mechanisms.

The concern about efficiency is simply that if resources are not put to the most useful purpose, and used with the most suitable technology available, the result in terms of real product and sustainable expenditure will be less than desirable. But the processes involved and their outcome have to attract wide support on the question of their fairness. Adjustment is an issue because technology and market preferences are dynamic — they change over time, sometimes quite rapidly. A system of resource allocation which is resistant to change may inhibit desirable responses. A study of the regulatory environment is likely to be useful in both respects of this economic debate.

1. Efficiency and Equity

Efficiency in the use of resources is desirable if we are to meet our economic objectives. Since the directives and prescriptions inherent in regulation affect the way things are done, they have the potential to influence efficiency in the economy.

Efficiency in the economy is not an absolute concept. Efficiency can only be recognised in relation to a set of values. (To some extent this embraces equity considerations.) The fastest or the easiest way to accomplish a task is only "efficient" if it is already established that the exercise in question is worth doing. For example, our society precludes some activities as criminal. Although there is debate about the appropriate boundary in some cases, there is none in a large number of others. Irrespective of the market valuation of their products, activities such as drug trafficking, embezzlement and hired murder are not judged to be additions to society's welfare. Less clear-cut questions arise in relation to the many trade-offs which arise between total real income and equity of distribution. Efficiency is always constrained by laws which reflect desirable social behaviour.

Interventionist policies have the potential to distort the economy, and thus constrain growth. Regulation can be expected to induce special forms of distortion and inflexibility. These range from the added costs to industry of compliance with legislation (or, for that matter, avoiding it), to lost profits from prohibited enterprises. While there are often problems in quantifying costs and lost opportunities, it is even more difficult to assess the beneficial effects of regulation. This is important because in the final analysis, policy judgements have to be made on the basis of whether the inconveniences are worth putting up with.

We can perhaps illustrate this with a simple example. Transport services are a very important sector in the economy. Among other things they carry traded goods from one end of the country to the other, and to and from international ports. Clearly the efficiency, and therefore the cost, of this is likely to be important to the international competitiveness of the producers of these goods. But there is also a case for safety of the drivers of trucks. By driving extremely long hours or at breakneck speeds, it might be possible to reduce the operator's costs significantly, but unfortunately this might be associated with more accidents, damage or injury to other parties, or hospitalisation costs. Whether some form of regulation of the hours of work for drivers and the establishment of road rules is the best response to dealing with this trade-off is central to the efficiency question. Assuming for the moment that some form of regulation is the only feasible approach to minimising the harmful effects of the competitive instincts of providers of transport services, the cost in terms of international competitiveness will be counterbalanced by a reduction in the costs of poor safety on the roads. If economic growth is being constrained by high costs in the transport sector, badly designed or excessive safety regulation constitutes a burden on the economy. The policy problem in such cases is to determine whether the trade-offs are pitched at the right level and approached in the appropriate way. Furthermore, the question is likely to involve weighing the different interests of road users and consumers of transported products so that equity issues will be raised.

2. Economic Adjustment

In order for economic change to take place in an orderly and satisfactory way, responses in particular parts of the economy should complement, and be complemented by, responses elsewhere. As a general rule, financial markets adjust much more quickly to changes in their environment than do product markets. Product markets in turn adjust more quickly than do the labour markets. Markets for the exchange of physical capital assets have a less obvious place in this spectrum. Capital assets which are fixed in terms of either location or function may be associated with very difficult adjustment problems, but assets which are readily transferable to other places and uses may adapt to economic change relatively quickly. If there are rigidities or complications built into these various adjustment mechanisms through regulation, important responses may be frustrated or even blocked. Moreover, the ability of product markets to adjust reasonably smoothly may be heavily influenced by what happens in factor markets (markets in which resources are exchanged). Labour market circumstances may, for example, make it difficult for producers to arrange production in the most desirable way. Likewise, some aspect of financial markets might make it difficult to match willing lenders

¹ Pincus, J.J. and Withers, G.A., "Economics of Regulation" in Gruen, F.H. (ed), *Survey of Australian Economics*, Edition III, 1983, pp 10-11

with borrowers wishing to invest or take commercial risks.

The adjustment issue is of particular relevance at this time given the extent of our economic problems and the bold changes in policy-making recently adopted. The economy is some distance from where The Monitoring Group would like it to be. Our adjustment problem, therefore, is rather more than the normal needed to facilitate mechanisms of orderly change.

Structure of the Report

In the next chapter the Monitoring Group examines the forces which generate the regulatory structure and other complex background issues which need some discussion if worthwhile progress is to be made. In Chapter 3 the characteristics of regulation are described. The impact on the economy together with some unresolved analytical issues is discussed in Chapter 4, and Chapter 5 draws some conclusions and deals with policy implications.

Chapter 2

The Nature of Regulation

The matrix of control influences, known broadly as regulation, operates alongside and amongst normal market influences, and has the potential to cause significant changes in what markets do and achieve. It is necessary to be able to assess the ways in which this occurs, and it is helpful to understand something of the social and political processes which lead to regulatory structures being established.

Recognising Regulation

Regulation, in the sense defined earlier, can be recognised in a number of ways:

- the legal system
- delegated administrative power
- threat and persuasion.

1. The Legal System

The enactment of legislation in Parliament is the primary level at which regulatory structures can be observed. The power of the executive branch of government (Cabinet) through the Governor-General to issue regulations² is an extremely important secondary level of legally binding rules. This second tier of the legal system is more specific and detailed, representing "the fine print" of the empowering Statutes. Because of the way they are formed, regulations may be changed more quickly and with less public debate (sometimes none) than passing parliamentary Acts. However, practice and tradition in New Zealand allow Acts to be passed or amended with considerable haste if the Government insists, or if the opposition acquiesces. Many regulations are nevertheless changed infrequently. The Acts of Parliament plus regulations issued under their authority combine to lay down "the rules of the game" which are enforceable through the courts. Monitoring Group research reveals a list of nearly 400 Acts of Parliament and 1,000 associated regulations which have potentially significant economic effects³. This study focuses mainly on central government as a source of regulatory conditioning of the economy. There is also a substantial network of local government which has powers to set rules that are an important part of the structure.

2. Administrative Authority

Government influence on the economy extends

² "Regulation" is used here in the technical, legal sense of subsidiary legislation outside the direct parliamentary processes, rather than in the general sense of constraints on markets, the subject of this report.

³ The list is available upon request from the New Zealand Planning Council. The state of this listing is still at a rather crude stage of development which, together with its bulk, is why it is not published with this report.

beyond the power to legislate or issue regulations. The Cabinet, either collectively or as individual Ministers, daily and weekly exercises the authority of government to operate the regulatory system. The nature of this varies because the background Statutes and regulations vary in detail and specificity. For example, the legislation may seek to bring specified prices under control, to control production, or to provide minimum safety standards. This might be done by explicitly detailing prices, quantities or safety specifications in the Act, but it is more likely that provision is made for regulations to be issued, or it is simply left to the Minister to quantify the intent of the Act ("as the Minister shall determine" is a common phrase in the Statutes). This feature is in fact built into a lot of legislation to allow it to operate with reasonable flexibility, but over time it can have the effect of exposing the mechanism to the whims of whoever happens to be able to influence the Minister of the day. However, Ministers are accountable to their colleagues and to the electorate, and the development of administrative law has allowed courts to ensure that Ministers consider all relevant considerations, and no irrelevant ones, in making their decisions. Regardless of this, the result is that there are many detailed administrative decisions, of greater or lesser economic importance, which the Government is regularly called on to make. This is fundamentally different in character from the duties of providing the legislative base itself, and is an important aspect of regulation.

The practical reality of overseeing and administering a great deal of written legislation is that operating decisions of this kind are largely delegated to a multitude of government departments, appointed inspectors, statutory authorities, boards and committees. The nature of the power vested in other institutions, and the economic importance of what is regulated in this way, vary enormously from case to case. Also, the chain of responsibility is often quite complex.

Administrative decisions made as a result of the existence of regulation, while outside those made by market participants themselves, are clearly not always made at a highly centralised level. In many cases the central government, including Public Service officials, does no more than put the regulatory mechanism in place. This is particularly likely to apply when large quantities of public funds are not involved (accountability for public expenditure usually entails a substantial element of central control and rule-setting).

Decentralisation and delegation raises complicated issues. One of these is the extent to which the controlling authority or officials can be "captured" by the market participants, or some of them. This can, especially over time, lead to situations in which regulation functions in ways quite different from the legislators' intentions. In studying the economic effects of particular pieces of regulation, it is necessary to be aware of these possibilities.

Also, there is no straightforward means of assessing whether regulation which delegates authority results in more or less adaptability to change. Sometimes it is feasible that the regulators are in close touch with current events, and might be expected to respond relatively more quickly to change. However, there is also a danger of patchy and fragmented decisions, made largely in isolation from other policy, and therefore more than probably inconsistent with it.

3. Threat and Persuasion

There is also an informal aspect of the regulatory system which acts as a sort of third force underlying its rules and institutions. The economic effects of regulation cannot be considered independently of the political processes which underlie its formal shape. Government power and to some extent that of its multiplicity of administrative bodies, derives not always from what they do, but from what they might do, and from their capacity for persuasion. Governments can use techniques ranging from moral suasion to blatant threat to get what they want. This operates as an interactive rectangle between government-appointed bodies, pressure groups, and the public. It is a question of balance. Very often interest groups are able to apply counter-threats of which either the Government or its appointed agents take note. Clearly it is possible to overestimate the strength of this sort of influence, but the authority of government is such that it can sometimes influence market responses simply by stating some kind of request, rather than by using its specific powers. (Indeed, what the Government is thought to want may be influential even if totally incorrect.)

The moral suasion approach, as opposed to the threat, will normally have much chance of being successful only if competitive forces are already limited. In New Zealand, the banking sector, which historically has been heavily regulated, was an example of a sector sensitive to normal suasion. If it wished to restrain lending, the Government could, by calling the leaders of the banks together, obtain voluntary agreement from the banks to do just that. Such an approach would have little chance in the more competitive system which prevails today. Banks and other financial institutions are competing vigorously for market shares and there is little chance of reaching a stable agreement. Banks would see themselves as losing market share to other institutions, not achieving the Govern-

ment's wishes, and losing profitability themselves.

The Origins of Regulation

Regulation is highly varied, and the origin of any particular regulation can often be found only by careful and detailed historical investigations. Ultimately, regulation can be regarded as part of the constitutional and legal framework of society whereby rights are established. Economic activity would be impossible if one could not establish ownership of property and have confidence that it could be enforced. Similarly, the law of contract provides means for ensuring that properly-made agreements will be carried out. There is little disagreement about the need for rules at this fundamental level, although of course there may be dispute over the application of the rules to any particular transaction, whether it be over the rights of a property-owner against the interests of neighbours, or over the meaning of a particular clause in a contract. But other rights may be more contentious in themselves. An export licence defines the rights of its holder and also narrows the rights of others to participate in a particular activity. The existence of general benefits then becomes less obvious, and it is useful to have some acquaintance with the broad streams of thought that led to regulation, if only to understand the complexities which have to be confronted by proposals for reform.

1. Public Interest

One group of hypotheses is that regulation is imposed in pursuit of the "public interest", in order to correct what are seen as defects or inequities in unregulated markets. European governments evolved over the long course of history from monarchs and aristocrats who were expected to have special insight into what was "good" and should be encouraged, and what should be prevented. There was a special requirement that society's weaker groups should be protected. This is one of the many philosophical streams which New Zealand inherited. Furthermore, New Zealand society was for a long time a small and mostly homogeneous one, with ready access to politicians and no belief that the "majesty" of government required it to remain aloof from day-to-day concerns of groups of citizens; New Zealand governments were therefore expected to respond to perceived difficulties and to use all the powers available to government to do so. The notion, "there should be a law against it", with the presumption that governments can be expected to be better informed than others about "proper" action and be equipped to act, is long-established in New Zealand.

More recently, especially from the 1930s on, governments in New Zealand and elsewhere have intervened in economies, by regulation or not, in reaction to what was seen as a particular market failure. Governments are again seen as paternalistic, acting so as to protect people from misfortunes beyond their control, but in

response to particular problems rather than from an accepted general superiority. An example would be regulations requiring life-boats on passenger ships in response to a demonstrated failure by some shipping company to carry enough life-boats as a result of its own judgement about what the market requires. More typical since the 1930s would be regulations seeking to ensure full employment because of dissatisfaction with the results of unregulated markets.

There is an inherent plausibility about the idea of government improvement on what would otherwise occur, but it is obviously incomplete. In the more concrete cases, why should individuals subject to injury risk not have sufficient incentive to take appropriate precautions at least as great as that of government? Possible reasons include the inability of individuals to get the information needed for an informed judgement about the worth of life-boats and the desirability of patronising only services which provide them, the difficulty for individuals of checking claims of competing services over the number and quality of life-boats provided, a lack of effective choice among services in getting between two particular points, and so on. More comprehensive explanations of regulations are needed, but there will often be a place for the traditional idea that "governments know better". This is true of more macroeconomic interventions where the debate is likely to be over whether regulations achieve their stated objective and over the acceptability or otherwise of incidental effects.

The fact that regulations do not always work well does not rule out this stream of explanations for their existence. The motive may be "public interest" even if the framing or enforcement of the regulation is deficient. Furthermore, the deficiency will often be in the detail of the regulation; for example, outdated requirements about the construction of life-boats after a new building material makes it possible to achieve an equal contribution to safety at lower cost, rather than in the requirement of life-preserving equipment.

2. Political Theories

A second approach to explaining the existence of regulation builds on individualist philosophy, and is especially prominent in writings in America where historically, the Government was likely to be seen as a remote, and perhaps irksome, influence rather than as a paternalistic guide. The individual is regarded as the best judge of his or her interests, but that may include seeking a change in the prevailing legislative rules.

Individuals therefore form coalitions and seek a victory through parliamentary institutions. Or the initiative may be in the reverse direction. Groups of individuals organised in political parties seek power by offering packages of policies, or promises to change the prevailing definition of rights, which are designed to attract majorities of voters. Those packages may in-

clude regulations which can be expected to attract more voters than they discourage. The notion of a "public interest" is displaced in favour of concentrating on "winners" and "losers". The latter may be more numerous but as long as not many cease to be supporters of the political coalition, while those whose commercial position is enhanced by a changed distribution of rights become more numerous or committed supporters, individualist behaviour may lead to regulatory intervention.

This conceptualisation of regulation has value. The insights it offers include paying attention to the cohesiveness of interest groups. A large but diffuse body, each member of which is affected only a little, may be less influential than a small group for whom a particular intervention may offer a big reward even if in total there is an overall loss. Or in what may be more important in New Zealand now, removal of an intervention may be difficult if it benefits many people only a little each but removes a powerful support to the interests of a small group. It is also useful to see the importance of lobbying to gain or retain some intervention. An important issue for governments to recognise is that policy changes may lead firms to make a judgement over whether the appropriate response is to change economic activity to take advantage of new opportunities, or to devote resources to trying to persuade the Government to change its mind, or to supporting political parties which are prepared to offer to reverse the policy change.

But the theory is only a starting point. It would be wrong not to see ideas of change and improvement as important to the New Zealand political processes. It is also important and often difficult to distinguish between interest group politics and the general need for a legislative framework which permits economic activity to proceed.

Coping with Regulation

Economic thinking is in a state of flux regarding the ability to assess the value of regulatory mechanisms. Regulation involves barriers to behaviour. Limits or conditions are imposed on what may be done, responsibilities are defined. Regulation involves some inflexibility. Some of the principal economic concerns are therefore its potential to restrict competition and to slow down the rate of technical change.

The degree of competition is often judged according to the number of participants in a particular market, although better analysis has always considered potential as well as actual participants and been concerned with performance as well as market structure. Such matters have recently become even more prominent. "Contestability" is now the usual measure by which competitive forces are assessed. The costs of entering and exiting a particular activity remain important and may be affected significantly by regulatory provision.

Technical change provides more output from given resources. It is immediately apparent that it is affected by social rules since it is there that judgements about the worth of some outputs are made effective. But the link with regulation is mainly through the issue of inflexibility. Once the rules are laid down, they must be adhered to (assuming they can be enforced) but technical change may make them inappropriate. In particular, it may become possible to achieve the original intention in some less costly way.

Whether one thinks in terms of the social and political processes by which the "public interest" is defined, or in terms of winners and losers, questions about regulation are likely to

involve issues of equity as well as of resource allocation. That increases the difficulty of distinguishing the basic rules of society from more dispensable interventions.

Consequently, it is important to recognise both that the regulatory environment may be important in damaging the economy's ability to reach our objectives of growth and equity, and that it is difficult to disentangle from fundamental social issues. It therefore requires continual reappraisal. The notion of a single solution to the question of what set of regulations is desirable seems to the Monitoring Group to be unrealistic and likely to lead only to a blind alley. For this reason, it favours the concept of "regulatory reform" rather than "deregulation".

Classifying Regulations

To accumulate some facts about economic regulation, a system of classification was devised. This was intended to facilitate examining the overall impact of particular forms of regulation. This chapter describes the overall rationale of this system, providing at the same time some specific examples. These examples are selected because they illustrate the different forms of regulatory structures, rather than because they are necessarily very important as far as the wider economy is concerned.

The system follows the example of some Canadian research⁴, and aims to identify the market characteristics affected or constrained by regulation, e.g. prices, inputs, quality etc. Essentially regulation has the effect of narrowing certain choice sets available to market participants, and the framework aims to identify these as specifically as possible.

The following is a list of specific but not mutually exclusive ways market behaviour can be regulated or constrained. The focus is on the method of regulation, not the objective.

1. Prices may be fixed or controlled
2. Entry of new investment may be restricted
3. Entry into occupations is restricted
4. Labour inputs are subject to conditions
5. Land and other natural resource use is regulated
6. Financial resources are regulated
7. Other inputs and processes are subject to control
8. Product quotas are set
9. Product quality is specified
10. Information requirements are prescribed
11. Service conditions are specified
12. Provision is made to collect industry levies.

The following describes in more detail how each particular form of restriction might be expected to work, and provides some examples from New Zealand legislation.

Price Control

The regulation of prices is a common form of policy intervention. In some cases legislation is used to set maximum prices, in others to set minimum prices.

Maximum prices are usually rationalised in terms of protecting consumers. The underlying assumption would usually be that in an unregulated situation, an absence of competition (i.e. a monopolistic pricing influence) would keep

prices above acceptable levels. Sometimes maximum prices are established across a range of products as an element of inflation control policy. In this vein in the 1970s we had in New Zealand profit controls which were a surrogate form of price control, in that firms which showed profit growth above a certain rate were required to demonstrate that they had not simultaneously raised prices.

Minimum price rules would normally be aimed at establishing "fair" prices for specified classes of producers. In a sense, this is the deliberate creation of a monopolistic influence. The stated aim would usually be the prevention of "weak selling".

Price regulation seldom deals very effectively with economic problems of any kind. It tends to deal with the symptoms rather than the causes. Prices are a feature of transactions which actually occur, which means willing buyers and sellers must be present. Attempts to regulate the price means the aspirations of one or the other must be frustrated, and strong incentives will exist to find alternative means of fulfilling them. Price control is usually associated with other forms of regulation such as rationing.

Among consumer prices controlled in New Zealand is the retail price of milk. Specifically the Milk Act 1967 (53), s. 25 provides legal underpinning of this price when it states:

“(1) There shall from time to time in accordance with this section be notified —
(a) The actual or the minimum prices at which milk produced or sold for human consumption may be bought or sold”.

Elsewhere in the Act, the authority to fix the price is delegated to the Minister of Agriculture after consultation with the New Zealand Milk Board and the legal price is announced by notice published in the Gazette. It is noteworthy that the wording of the Act seems to provide for regulation of prices of town milk at primary and intermediate stages of production and distribution.

As an example of producer price control, we cite the Apple and Pear Marketing Act 1971. The main function of the Act is to set up the Apple and Pear Marketing Board, i.e. to control entry into export marketing (see below), but a subsidiary function is to establish a pricing authority which determines the prices which will be paid to pip fruit growers.

e.g. s.2(1) of the Act:
“(1) The general function of the Authority will be —
(a) To determine in each season, in accord-

⁴ Stanbury, W.T., "Regulation in the Canadian Economy: An Overview" in Brinkman, G.L. (ed), *Regulation in Agriculture*, Proceedings of the 1982 Canadian Agricultural Economics Society Workshop

- ance with this part of this Act -
- (i) *The average price to be paid by the Board for apples that are produced in New Zealand . . . and*
- (ii) *. . . pears . . .*"

The dairy industry is subject to a similar structure limiting entry for marketing of processed products and determining raw material prices for producers. The Dairy Board Act 1961 (5) s.24 defines the functions of the Dairy Products Prices Authority which is established under the Act:

"Function of Authority —
The general function of the Authority shall be to establish . . . the value to be placed upon milkfat and solids-not-fat in the determination of the prices payable by the Board for the dairy produce acquired by it . . ."

This particular example is interesting in that the prices are set at the producer level (i.e. the raw material cost of dairy processing factories) and the marketing entry restriction applies to the processed product. The processing companies (which are also licensed) sit in-between controlled raw material prices (intended to protect the farmers) and compulsory purchase of the processed output by the Dairy Board. It would, however, be hasty to interpret from this that incumbent dairy processing factories are disadvantaged by the legislation of price control and compulsory purchase. There are other complications, such as the fact that dairy processing operations may be much less risky in the highly regulated environment. Moreover, the Dairy Board's operations have to an extent been assisted by government and Reserve Bank financial privileges. The selective advantage of this flows back through the system affecting both prices and volume of product. About all we can say at this stage is that the processing factories do not operate in a "normal" commercial environment. While their activities are constrained in many ways, they gain many potential advantages of product through-put and price certainty as a result of the system.

Investment Entry Restrictions

By investment entry we are referring to the right of new participants to "set up shop" in competition with incumbents, rather than control of investment as such. It is a convenient nomenclature to distinguish this particular form of control from occupational entry restrictions, the next one on the list. Restrictions on new investment activity, even for incumbents, does in fact occur, but in our system this would be classed as a form of input restriction (see below).

Entry regulation usually takes the form of licensing, or other administrative procedures which in effect mean that official approval is required for enterprises to be in business. The presence of a licensing system in an industry does not necessarily amount to entry restriction if its function is solely to provide a register of participants for some other (probably regula-

tory) purpose. However, the more usual situation will be one where the entrant is required to fulfil specific conditions before a licence will be granted. The most stringent form of entry restriction occurs when the number of firms engaged in an activity is controlled by the regulators.

Policies of this kind are on the face of it either intended to ensure minimum standards of service, or to promote industry stability. In economic terms problems arise from the restriction of competition. In particular, over time, potential new entrants to the industry who may bring improved services or products and/or more efficient production technologies are likely to be blocked. In a rapidly changing world there is no reason to believe that incumbents in an industry are the only source of such improvements.

The Air Services Licensing Act 1983 administered by the Ministry of Transport is a good example of such legislation. Under s.14(1) it is plainly stated that:

"Every person commits an offence and is liable on summary conviction to a fine not exceeding \$10,000 who —

(a) Carries on an air service otherwise than pursuant to the authority of a licence".

As is apparent from recent changes, the impact of this regulation depends on the freedom with which licenses are issued.

Another example of entry restriction, in this particular case imposed for moral objectives, is the Massage Parlours Act 1978. We quote from s.5 of the Act:

"Massage parlour operators to be licensed —
(1) No person shall carry on the business of operating a massage parlour unless he is the holder of a license issued under this Act".

Again it is the extent to which licenses are in fact issued to worthy applicants and refused to unworthy ones which determines whether the regulation serves the public interest.

Occupational Entry Restricted

This form of regulation involves the registration or licensing of specified occupations. The precise effect of restriction may or may not limit the number of participants in a trade, craft, or profession. The degree of severity generally hinges on the qualifications for admission rather than explicit control over numbers. It is noticeable that our regulations are usually restrictive in that entry to some occupations is made dependent on a registration process. It is much rarer for registration to be used to mark the satisfaction of some criteria while allowing registered and unregistered practitioners to compete, so leaving it to the user to decide whether or not the criteria are important. Possibilities range from routine registration on the basis of reasonably general characteristics, through to various formal qualification and experience requirements. Among the most stringent occupational entry arrangements are some of the

trade examination and apprenticeship schemes, and the medical and legal professions where not only are extensive university qualifications required but entrants need to persuade the controlling authorities that they have acceptable personal characteristics.

The public justification for occupational entry restriction is almost always consumer or user protection. Included occupations are regarded as being sufficiently specialised or sufficiently important, that the state has a responsibility to set standards. The understanding is that those who hire or employ such people do not have ready access to information concerning their abilities.

However, there are economic costs if the qualification standards are set too rigidly. If occupational entrants are required to attain skill proficiency grossly in excess of what is strictly necessary to perform the economic function required of them, the costs to society of training them will be too high. Who bears these costs will depend on how training is financed. It may be the industries and consumers that employ people from the trades and professions, but in many cases it is likely to be the public purse.

Regardless of how the training is financed, the potential exists for "exclusivity" to be reflected in occupational incomes. The likelihood of this is enhanced rather than reduced if the qualifications are manifestly greater than the economic need, or if numbers are limited in some way. Skilled professions have an economic incentive to become regulated. Even if the high costs of training have been directly borne by incumbents (and this will always be the case to some extent if only because of the considerable sacrifice of time involved), a successful campaign to come under licensing or registration brings with it an opportunity to recoup them.

As examples we refer to legislation providing for registration of architects and plumbers.

The Architects Act 1963 (12) s.16 says:

"(1) Every person shall be entitled to obtain from the Board a direction for his registration as an architect who satisfies the board —

(a) . . . he is not less than 21 . . .

(b) . . . he is of good character and reputation

(c) . . . he possesses any one of the following qualifications, namely —"

— and details of qualifications are listed.

It is made clear elsewhere in the Act that the services of any person operating in this area will be severely hampered if they do not have the sanction of registration by the New Zealand Institute of Architects. In particular it is illegal to present themselves as "architects". Quoting from s.53 (1):

" . . . every person commits an offence . . . who . . . not being an architect registered under this Act, uses . . . the word 'architect' . . . which may

. . . cause any person to believe that the person is an architect".

Nevertheless, there appears to be nothing illegal about engaging in low level building design, the draughting of plans, etc. (e.g. for a standard family house, additions and the like) and other work which many would regard as being a close substitute for architecture. Despite this, the prestige associated with being a registered architect is likely to preclude a large amount of this kind of substitution.

The trade of plumbing is regulated by means of the Plumbers, Gasfitters and Drainlayers Act 1976. Quoting:

"s.23 Qualifications for registration as a plumber . . . Subject to section 27 . . . a person shall . . . be entitled to be registered as a plumber if he satisfies the Board — . . ."

"s.36 (2) Except as provided in section 38 . . . no registered person shall in any year be entitled to do any sanitary plumbing unless he is the holder of a craftsman plumber's licence or a registered plumber's licence . . ."

As in the case of architects, there may be fringe operators who are potential cheaper substitutes for formally qualified and registered people. With plumbing, it is in fact illegal to do certain plumbing tasks unless one is registered, however some exemptions are provided for in the Act. Under Section 38 provision is made for the issue of "limited certificates" to do sanitary plumbing, whilst Section 56A allows persons to do sanitary plumbing on some commercial and industrial premises, provided they satisfy the board they are competent to do so. Furthermore, the Sanitary Plumbing (Permission for Householders) Notice (No. 2) 1983 specifies some (rural) areas where householders may do their own sanitary plumbing.

Labour Inputs Regulated

A considerable body of legislation places constraints on the manner in which employers may hire and utilise labour. Usually these measures are aimed at protecting the interests of workers. They range from the setting of minimum rates of pay to working conditions regarding safety, health, terms of dismissal, holidays, and a host of other matters.

Sometimes, as an element in overall incomes policy and inflation control, maximum rates of pay or conditions are established by legislation. The recent wage freeze, which began in 1982 and was extended until towards the end of 1984, was an example of such regulation.

The following are some important Acts regulating the labour market:

- Agricultural Workers Act 1977
- Equal Pay Act 1972
- Holidays Act 1981
- Maternity Leave and Employment Protection Act 1980
- Minimum Wage Act 1983

The Agricultural Workers Act imposes obligations on rural employers, among other things, to provide accommodation to workers. This is an obligation not normally associated with employing labour, but it reflects the special traditions as well as the geography of the rural economy.

"Part V. Accommodation for Workers

s.49 (1) . . . it shall be the duty of every employer to provide sufficient and suitable accommodation for every agriculture worker employed by him.

(3) . . . shall not apply in the case of any agricultural worker, who, —

(a) . . . can conveniently sleep at his own home

(b) . . . Chooses to provide his own sleeping accommodation

(c) . . . Is married and accompanied by family".

Clearly much of the language in the sections quoted is rather general (e.g. "sufficient and suitable accommodation", "conveniently sleep at his own home", etc.). This illustrates how legislation can become complex so as to provide for reasonable exceptions and at the same time to have its overall intent complied with. In fact other sections of the same Act lay down provisions for a system of inspectors to monitor and enforce its provisions. The economic effect of the legislation will be determined by the operating rules provided for these inspectors and the way they interpret them.

A different example which illustrates legislation which imposes conditions and costs on employers is the Maternity Leave and Employment Protection Act 1980 which establishes the right of female employees to unpaid leave for childbirth. Quoting:

"s.5 Entitlement of pregnant women to maternity leave —

. . . every female employee —

(a) who becomes pregnant, and

(b) who, at the expected date of delivery . . . will have been, for the immediately preceding 18 months, in the employment of the same employer for at least 15 hours a week, —

shall be entitled to maternity leave in accordance with this Act."

Further to this the employer is obligated.

"s.15 Obligation to notify employee —

. . . (if) her position —

(a) (i) can be kept open or

(ii) cannot be kept open;"

"s.16 Presumption that employee's position can be kept open . . . unless

(a) . . . a temporary replacement is not reasonably practicable due to the key position occupied by the employee; or

(b) because of the occurrence of a redundancy situation".

We note further that the existence of a "key position" is determined among other things by

the size of the employer's enterprise (i.e. small establishments are exempt), and the training period or skills required on the job.

The legislation is clearly intended to facilitate social change towards equality of opportunity for males and females but it is complex and not necessarily predictable how advantageous it will be in terms of its intention. An immediate potential problem is the higher associated non-wage cost of employing women in relation to equivalently qualified men. It seems likely that the Act would be effective only in relatively unskilled occupations. Although other regulation (i.e. Human Rights Act) protects women from discrimination in the professions, the possibility that the Act would not be fully applied in practice seems very real.

e.g. Human Rights Commission Act 1977, s.15(1)

"It shall be unlawful for any person who is an employer

(a) To refuse or omit to employ any person on work of any description . . . by reason of the sex, marital status, or religious or ethical belief of that person".

The setting of minimum wages is a feature of labour legislation designed to provide a standard of living "safety net" to workers. It is based on the premise that individuals may not have the bargaining power to negotiate an acceptable rate. As long as wages are settled in individual awards above the minimum, this legislation will not affect the economy. Otherwise it represents a judgement that the opportunities for work which do not provide a minimum reward are not socially acceptable. The appropriate level might well change with trends in unemployment, more quickly than the regulation can be adjusted.

Minimum Wage Act:

"s.4 Prescription of Minimum Wages

(1) The Governor-General may from time to time . . . prescribe the minimum rates of wages payable to any class or classes of workers . . .

(2) Any minimum rate of wages prescribed . . . may be . . . as a monetary amount or as a percentage of any other minimum rate of wages".

Land and Other Natural Resource Use Regulation

It is very common for restrictions to be placed on the use of land. Town planning and zoning bylaws of local authorities are one dimension of this. The establishment of reserves, national parks and recreation areas is another. The rationale for such restriction is complex, but can probably most easily be summarised in terms of the effects of certain types of development on the surrounding properties and on the environment generally. There are seen to be externalities if regulation does not exist. From the property-owner's point of view, it is very clear that land use regulation imposes restrictions on the rate of return achievable,

whether through costs incurred in complying with restrictions, or limitations in choice of development option. As long as information regarding legal options is fully available at the time of purchase, the market price of land should fall sufficiently to accommodate such difficulties. Of course, there may be significant costs incurred in gathering the relevant information.

It is not necessarily the case that the market value of land use rights falls as a result of regulation. In fact there are very many cases where the exact reverse is likely to be true. If as a result of zoning, for example, industrial development is permitted in certain areas only, this may limit the supply of industrial land in relation to demand and cause its market price to rise above the price it would have if industrial land were not restricted. Furthermore the prevention of industrial development in residential areas may increase the value of the assets of landholders in these areas. Clearly this advances all kinds of possibilities for the owners of land property rights to seek to have land use regulated.

Examples of land use regulation are many, and we cite section s1(1) of the Town and Country Planning Act 1977 as being typical.

"Power to acquire land, etc. —

(1) In addition to any power it may have to acquire land for any public work . . . the Council may . . . acquire under the Public Works Act 1928 any land . . . (it) considers . . . necessary to do so for —

(a) The proper development or use of the land; or

(b) The improvement of areas that are too closely subdivided; or

(c) The purpose of terminating any use of any land or building that does not conform . . .

(d) The provision or preservation of amenities".

Another example of land use regulation in respect of natural resource use is found in the Mining Act 1981. Part 3 of this Act details the land open for mining.

"s.21 Crown land open for mining — All Crown land shall be open for mining, subject to and in accordance with the provisions of this Act.

s.30 Maori land open for mining — (1) All Maori land shall, with the written consent in the prescribed form of the owners and occupiers, be open for mining.

s.35 Private land open for mining where minerals not owned by the Crown — All private land the minerals on or under which are not owned by the Crown shall, with the written consent in the prescribed form of the owner and occupier of the land and the owner of the minerals, be open for mining . . ."

However, the real power of the Act is embodied in Section 37 of the Act. It states:

"s.37 Private land, Maori land may be declared open for mining without consent of owner — (1) If the owner or occupier of any private land or Maori land fails or refuses to consent to the grant of a mining privilege in respect of the land".

Then the person who wishes to obtain a mining privilege in respect of the land may apply to the Secretary to have the land declared to be open for mining as if it were Crown land. (Certain land is exempt, for example, land under crop, land situated 30 metres from a garden, orchard or cemetery.) On receiving an application, the Secretary reports on it to the Minister of Energy who may authorise a geologist to make a survey of the land and if, in the geologist's opinion, there is a reasonable likelihood of the land containing any mineral in payable quantities or that it is of geological interest, the land may be declared to be open for mining.

Financial Regulation

Financial regulation, looked at in one way, is not fundamentally different from price, quantity and quality regulation in other sectors. Its importance stems from the role the finance sector plays in financing expenditures, particularly investment expenditures, throughout the economy. The financial sector therefore represents an element in the input structure of all sectors in the economy, and strongly influences additions to the fixed capital stocks. We find it helpful, therefore, to classify it as a special form of input regulation in the economy. Its importance lies in the fact that regulation may reduce the flexibility financial institutions have to provide finance for highly specialised or unusually risky enterprises, or other kinds of activity. The outcome is likely to be an absence (or at least a reduction) of activity which depends on financial services which regulation rules out. There may be more certainty, but this will be at the expense of innovation and the setting up of new enterprises.

The last 12 months have seen an extraordinary revision of the financial regulatory structure. Interest rates and portfolios are much less regulated now than they have been in living memory. This means the examples quoted are examples of the way financial services have been regulated rather than descriptions of the existing structure.

The Private Savings Bank Act 1983 s.7:

"The functions of every private savings bank shall be:

(a) To carry on the business of banking in the following forms:

(i) The receipt of money on current account or on deposit;

(ii) The payment and collection of cheques;

(iii) The investment and lending of money;

(iv) . . ."

Thus far, the legislation does not indicate anything particularly restrictive, but the sting lies

in the Regulations and Orders in Council which might arise under s.10:

"Subject to any Order in Council or regulations made under this or any other Act, a savings bank company may pay interest on money received at such a rate . . . as the savings bank . . . may from time to time determine."

Much of the language of this legislation is the direct descendant from nineteenth century provisions, when it was thought necessary to use government power to assure small savers that their deposits would be prudently managed, itself a view derived from the traditional idea that regulation of money was undoubtedly a responsibility of the monarch. That it is now desirable to restrict financial institutions to particular activities rather than to permit them to evolve in a competitive setting of the financial sector as a whole is much less clear, and indeed is now under active consideration.

Other Input and Process Restrictions

Besides restrictions on the way enterprises can use labour, land or finance as inputs, there can be restrictions on other inputs. As with labour inputs, these are often associated with safety or health aspects. Unlike labour constraints, however, they are sometimes (but by no means always) aimed at protecting the interests of third parties, e.g. The Clean Air Act 1972 s.7(1) obliges factories

"(a) To collect and contain any air pollutant and to minimise . . . the emission of air pollutants from those premises; and

(b) To render any air pollutant emitted from these premises harmless and inoffensive".

Another part of the Act, s.6, indicates that

"(1) There shall be a Council to be known as the Clear Air Council.

(2) The principal functions of the Council shall be

(a) To make recommendations to the Minister on such matters . . . and on such questions relating to the . . . scope and content of any regulations proposed to be made under this Act . . ."

None of this explicitly constrains business inputs unless the council makes recommendations upon which the Minister acts. We note, therefore, the Clean Air Zone (Christchurch) Order 1977 which contains strict limits on emissions into the atmosphere in the city of Christchurch.

A similar example of such legislation is the Noise Control Act 1982 which indicates under s.5(1):

"It shall be the duty of the occupier of any premises to adopt the best practicable means of ensuring that the emission of noise . . . does not exceed a reasonable level"

and under s.4(1) allows that:

"A local authority may designate any of its officers as noise control officers for the purposes of this Act".

Both these examples essentially represent the judgement that there is no way of ensuring the costs of a by-product of economic (or other) activity, air pollution and noise respectively, fall on those who are responsible for their creation.

Health and safety requirements are often implemented specifically to protect workers and are classified as labour restrictions. But they are also used to protect third parties (e.g. passers-by) and consumers. For example, hygiene requirements in food processing establishments assume that buyers of products do not have the necessary information to know whether adequate practices are followed in factories. Against this, manufacturers may have an incentive to implement similar practices in order to establish a track record with the consuming public and to make it known by establishing brand images symbolising quality. The Factories and Commercial Premises Act 1981 is an important source of such input restrictions. Because these are largely related to the safety of workers, they could be regarded as labour restrictions. However as they also involve provision of safety to consumers and third parties, they can usefully be classified here. The provisions of the following legislation contain elements of both labour and other input restrictions.

"Part IV Safety Health and Welfare

s.21 Protective clothing and equipment

s.22 Storage of dangerous substances

s.28 Safe place of employment

s.33 Cleanliness

s.39 Sanitary conveniences

s.47 Protection from harmful noise".

Production Quotas

Production quotas are a means of dividing market share by regulation. They are often a consequence of other intervention, for example, subsidy or regulation of prices which results in supplies larger than can be cleared at prevailing prices. In New Zealand and elsewhere, quota regulation occurs in the agricultural sector.

The New Zealand fishing industry is an area subject to control under the Fishing Act 1983. This Act controls the registration of fishing vessels and the issuing of licenses as well as the provision to apply quotas to certain species of fish.

"s.30 Declaration of controlled fisheries —

(1) On the recommendation of the Minister, after consultation with the New Zealand Fishing Industry Board, the Governor-General may . . . declare any part of New Zealand fisheries waters (including any fishery management area or part thereof) to be a controlled fishery under this Act for the purposes of the management or conservation of the fishery in that part of the economic stability of the fishing industry.

(2) The Minister may, following the declaration of a controlled fishery, by notice in the Gazette,

— (a) Define the controlled fishery by reference to such matters as he thinks fit, including the species or class of fish, aquatic life, or seaweed that may be taken from the fishery, the areas that may be fished, and the persons who may be engaged in the fishery; and

(b) After having regard to the provisions of any plan in respect of a fishery and to the recommendations of the Fishing Industry Board, fix the maximum number of licenses and boat authorities that may be granted in respect of the controlled fishery."

Whilst the stated objective is the management, conservation or economic stability of the fishing industry, the Monitoring Group is primarily interested in the methods used to obtain these objectives. One such method is prescribing the amount of fish (quota) which can be taken from certain areas.

The wheat and milling industry is heavily regulated regarding entry. For the present purposes we note provisions of the Wheat Board Act 1965:

"Part IV Dealings in Flour

s.34 Quotas for flour —

(1) The Board shall . . . every year fix in respect of every mill a quota of flour which may be sold from that mill and may from time to time during that year fix monthly quotas in respect of that mill".

This arose because some earlier attempts to deal with possible monopolisation of the flour milling industry through legislation failed to survive legal challenges; the state therefore joined in to supervise the industry. The whole arrangement is currently under review.

Production Quality

Production quality is usually explained as protecting the consumer from inferior products, and the issues are similar to those of regulation of occupational entry.

As an example, note the Potato Industry Act 1977 (77):

"s.35 Regulations — the Governor-General may . . . make regulations for all or any of the following purposes

(a) Prescribing a minimum quality standard scheme under which potatoes below a specified size and quality standard may not legally be sold for human consumption in New Zealand".

Regulation involving production quality can also

5 Defined as a pair of pyjamas, an over-garment of pyjama style, a nightdress, or a dressing gown, which, under Standard Specification for Children's Night Clothes Having Low Fire Risk (NZS 8705), is suitable for children aged 12 months to 14 years inclusive.

be associated with safety issues. An example of this is the Safety of Children's Night Clothes Act 1977. Under Section 3 of this Act all garments⁵ must be classified either as Class I garments, that is, those which comply with certain fabric specifications (Standard Specification for Low Risk Fabrics for Children's Night Clothes NZS 8704) and design specifications (NZS 8705), or Class II garments, that is, those which comply only with the design specifications. Furthermore, Section 4 states that, "In the course of selling a Class II garment" its description "shall not include the words 'low fire risk garment' or any words implying that the fabric of the garment has a low fire risk". The Act goes on to ensure that certain instructions and warnings are fixed to garments.

It is more than likely that public reaction to particular incidents of burning has led to this regulation. It is basically designed to improve the product quality and the standard of information available to consumers on the potential risks associated with the use of certain garments. The issue is slightly more complex given the fact that the direct consumer, and therefore the person to suffer the greatest harm, is the child, who is, we assume, unaware of the risks and not in a position to decide on whether safety is an important consideration.

In New Zealand, much of the production quality legislation takes quite a different form, in that it is a means of regulating primary export industries. The rationale for this is that export markets would be damaged by the appearance of poor quality produce. Essentially this is similar to brand image promotion such as might be undertaken by private producers, but its backing with legislation restricts marketing options. The externality argument — the way in which one marketer's poor product may damage the reputation of all exporters — has some power, but needs to be scrutinised to ensure that it does not become an instrument for protecting existing participants from new competitors.

In this regard the following are noted:

The Meat Act 1981 (56)

"Part II Sale of Meat and other products for Human Consumption

s.11 Conditions in respect of export of meat

(1) . . . no meat shall be exported from New Zealand unless —

(b) It has been inspected . . . and has been passed as free from disease . . .

s.12 Diseased or defective product not to be sold

(1) No person shall sell or offer for sale for human consumption . . . any product which in his knowledge is diseased or defective".

Information Required

Information requirements have protection of the

consumer in mind. The difference is only that the product or the process is not regulated as such, but that certain information about its content, price, or effects must be purveyed to the buyer, usually by some form of labelling. Sometimes these might be regarded as highly restrictive in that they might be considered a form of advertising advising against purchase. Requirements to display information about the dangers to health on packets of cigarettes is perhaps the clearest example of this. The judgement required is whether the costs to society generally are known to the individual purchaser. Others, such as the display of poison warnings on chemical weedkillers, certain pharmaceuticals, etc. would not be regarded in the same light. Indeed, manufacturers might willingly display such information without regulation because the message of danger might be thought to enhance the image of the product's effectiveness. (Laws regarding liability for injury may also constitute an incentive to display warnings without specific legislation.)

The Consumer Information Act 1969 is an example of information regulation. Its preamble says:

"An Act to make provision for the informative labelling and marking of goods and for the prevention of deceptive or misleading packaging, labelling, and advertising".

There follow a number of quite specific requirements such as

"s.3 Name and address of packager to be shown on packaged goods —" and *"s.4 Quantity of goods to be shown in respect of specified goods —"*

The argument here is that a market economy works well when purchasers have adequate information on which to decide the allocation of their incomes.

Service Conditions

This form of restriction deals not with the form goods take or the way they are produced, but with the question of to whom producers may or may not sell them. Both prevention and compulsion play a part. For example, it is illegal to sell liquor to people under a certain age. On the other hand, it is illegal to refuse rental accommodation to tenants on the grounds that they are members of any race or religion. Sometimes this sort of provision is associated with entry licensing, e.g. a firm might be given an export licence on the condition that it attempts to develop sales in a particular market.

Sale of Liquor Act 1962

"s.259 Supply of Liquor to minors —"

(1) Every person commits an offence and is liable to a fine . . . who . . . supplies any liquor to any person who is under the age of 20 years".

These provisions represent community judge-

ments on what goods and services are acceptable, much as the criminal law does.

Another example of service conditions is the regulation governing shop trading hours. Under Section 11 of the Shop Trading Hours Act 1977 *"subject to the provisions of the Act, no shop shall be open —"*

(a) Between 9 p.m. on any day and 7 a.m. on the following day.

(b) On any day that is a Sunday, New Year's Day . . ."

Although some liberalisation occurred under the Shop Trading Hours Amendment Act 1980, the regulations associated with Sunday trading are still the subject of much debate.

Levy Powers

In a great many industries, an industry association is given powers to collect levies from individual producers for certain industry purposes. Usually this is seen to be in the longer term interest of the industry itself, e.g. for market promotion, product or process research, or to advise government on policies affecting the industry. An example is the Berryfruit Levy Act 1967 which is an Act designed to *"authorise the levy of berryfruit growers to provide money for the promotion, development and improvement of the berryfruit growing industry"*.

This will not always so clearly be the case, as for example: Alcoholic Liquor Advisory Council Act 1981 makes *"provision for the funding of the Council's activities by means of a levy on alcoholic liquor imported into or manufactured in New Zealand"*.

In view of the activities of the council in attempting to restrain liquor consumption, it seems plausible that the breweries and other suppliers of liquor would regard this as a restriction on their activities. Others however, would see it as ensuring that liquor suppliers pay the total social costs of their activities.

Summary

We can see from this brief overview of how market outcomes might be constrained (not necessarily always for a worse outcome), that all the forms of regulation have similar intentions and effects. The static outcomes are likely to be affected, and it is clear there is considerable potential for prices to be distorted, and therefore for resource allocation effects to spread to other markets.

However, the really important influences are more likely to be the dynamic ones, that is, those apparent only over a period of time. The passage of time brings with it technical change and resource scarcity shifts. Regulation may in effect freeze or drastically slow down aspects of this dynamic process.

Chapter 4

Observations about Regulation in New Zealand

There are no well-established analytical techniques that enable assessment of relative price shifts and other structural effects due to regulation, especially on an economy-wide basis⁶. Nevertheless some preliminary judgements are possible. There is a handful of studies relating

to New Zealand from which the Monitoring Group has benefited. However this general subject needs to be taken up more widely. In the concluding chapter some suggestions are made regarding the establishment of an appropriate mechanism to pursue this.

Table 1

Summary of Restrictions

Control	Restrictions	Economy	Safety Health	Environment	Public Goods	Public Morality
Price	18	*				
Entry (investment)	142	*	+			+
Inputs	78	+	*	*	*	
Finance	37	*				
Land	24	*		*		
Labour	46	*	*		*	
Product quality	30	+	*		+	
Information	44	+	*			
Condition	82		+		+	
Quota	2	*		+		
Levy	23	*	+	+		
Entry (occupation)	41	+	*			

Key

* — form of restriction strongly associated with policy area

+ — form of restriction weakly associated with policy area

It is useful to begin by summarising the incidence of different regulatory restrictions. These are depicted in Table 1 which is intended only as a rough and ready starting point. It summarises the policy objectives particular types of regulation seem to be associated with. It has been derived from an examination of the data base of regulations.

There are five identifiable areas of government policy interest which appear to motivate regulatory policies:

- economic management regulation
- safety and health regulation
- environmental protection regulation
- regulation associated with public goods
- regulation concerned with public morality

The sequence of the discussion follows these headings. The distinctions between them are

⁶ There is an extensive literature and practical experience in the use of measures of "effective rates of protection" to assess resource allocation effects of import tariffs. This methodology can be extended to analyse the effects of any form of budget transfer — taxes and subsidies — on resource allocation. No corresponding methodology is in common use for intervention through regulation.

not clear-cut, and there is considerable overlap between them. These are of course the "obvious" motives rather than any indirect ones which, as has been indicated in Chapter 2, might be at the heart of the matter.

Economic Regulation

Table 1 indicates that economic objectives are associated with most of the forms of regulation the Monitoring Group has identified. The performance of the economy is conventionally measured by its ability to provide growth, stability, employment and an acceptable income distribution. There are numerous circumstances in which it is held that the free market outcome is not delivering one or more of these criteria and that regulation can provide an improvement.

Regulation of entry (particularly of investment), prices, production quotas, land and financial inputs, and to some extent labour inputs, appear to be prominent instruments of economic management. The power to collect levies is also usually associated with some specific industrial purpose. The weight of formal econ-

omic argument questions the value of much of this regulation, although circumstances of market failure, slow adjustment, limited competition can arise which might warrant it.

Entry restrictions are regarded as likely to be particularly damaging because of their potential for slowing down the rate of innovation. Other forms of control are also often regarded as inappropriate ways to guide industrial pricing and production decisions in the economy. They tend to deal with the symptoms rather than the disease. Among other problems they frequently lead to indirect restrictive effects.

There may be quite valid reasons for some kinds of regulation, as was suggested in Chapter 2. It is, nevertheless, very easy to over-emphasise them. There is very little research in New Zealand which makes it clear what effects economic regulation has in practice. Some studies have been done in very selected areas, and the thrust of these points very clearly in the direction that much of our economic regulation has had harmful effects. Of especial interest is a series of studies carried out by the New Zealand Institute of Economic Research. These studies address current situations, and look at a number of situations in which there have been significant changes in the regulatory circumstances⁷. Other isolated studies examine particular industries and recommend changes in regulation.

The regulatory changes reviewed by the Institute all involve a greater dependence on markets as the determinant of business behaviour. In all cases there is some evidence that regulation shifts relative prices. In each case these could be interpreted as changing New Zealand's real exchange rate, which is a central thrust of current policy objectives. For example, relaxation of entry controls on foreign exchange dealing appears to have reduced cross-subsidisation within the financial sector so that businesses using foreign exchange (i.e. producers of tradeables) have cheaper services, and the financial sector no longer finds it profitable to use captive margins on foreign exchange trading to reduce internal banking charges (a large proportion of which services non-tradeables activity). As an earlier Monitoring Group report reasoned, these are the sorts of changes which are needed if New Zealand is to reach a higher sustainable growth path.

Looking at industrial entry restrictions in particular, we can briefly examine their frequency in New Zealand and suggest some judgements regarding the significance of its impact on the economy. Of the 388 Acts the Monitoring Group has examined, 142 seem to entail entry restriction of one form or another. The following sectors appear to be quite comprehensively regulated for entry:

Processing and marketing of primary products

Energy production and distribution
Transport services*
Financial intermediaries and services*
Production and distribution of alcoholic beverages
Broadcasting
Telecommunications

(Recent policy changes have substantially reduced entry regulation in those sectors marked with an asterisk.)

In addition to this, there are quite a number of miscellaneous activities, mostly in the services sector, for which entry is restricted. Individually, their effect is almost certainly quite minor, and there may be valid reasons for their existence. In aggregate, however, they may be of some significance, and should not be forgotten in policy review exercises. Included in this are fishing, private schools, private hospitals, second-hand dealing, real estate agencies, trading in antiquities, operation of employment agencies, and pawnbroking businesses.

Price controls and quotas do not appear to be a widespread form of regulation in terms of the number of statutes which involve them. However, those that do would appear to be some of the messiest and most economically distorting interventions in the system, and some quite important industries are subject to them. The compulsory collection of levies to finance promotion, research, and other industry-related activities is worthy of some comment. The case for this is generally based on what economists call the "free rider" problem — the possibility that the benefits of promotion and the like will be enjoyed by incumbents whether they have paid for it or not⁸. It is also held that in some sorts of activities, stability, competitiveness or long-term growth may depend on product development or other forms of innovation which for various reasons individual participants do not have the resources or incentives to pursue. The Monitoring Group's main observation about this sort of arrangement is that at least it operates on a user pays basis (i.e. the costs of the jointly-funded research are borne within the industry which "benefits"), and is therefore preferable in many instances to the funding of such activities from general government expenditure. The Monitoring Group would be much more concerned about compulsory levies which are associated with severe entry restrictions than with the principle as such.

The virtual absence of any entry restriction in manufacturing industries cannot be taken at face value because entry and competition in manufacturing have been largely governed by the system of import licensing. The shift in the policy rationale in relation to import licensing is a good example of how the same control system can give rise to completely new arguments with the passage of time, and can remain

firmly cemented in place long after the reason for its introduction is apparent. From a foreign exchange control mechanism when it was first introduced in 1938, by the end of World War II it had evolved into an important instrument of industrial development.

Financial markets were, until very recently, one of the most regulated areas of the economy. They are now substantially free from restrictive entry controls and strict limits on many other aspects of servicing the economy. There is convincing evidence of gains in economic efficiency resulting from this, although some time yet is needed before the new environment can be rigorously assessed. Most equity concerns are satisfactorily dealt with by the fact that deregulated financial markets allow people to assume knowingly market risks *and* to share in the profits and losses. It is worth bearing in mind that if the risks are real, there will in fact be some losses as well as high profits. If the risks are not real, this will quickly become apparent in the market and high profits will be trimmed to competitive levels. Returns overall, therefore, should not be excessive.

The possibility that the system may not be stable now that there are very few operating rules in place, needs to be considered. Substantial fluctuations in profitability in the short term may be unsettling, but it is of no real concern as long as the institutions are able to absorb them without collapsing. Clearly information is less than perfect and depositors in a particular institution may not fully appreciate the extent to which they are exposed to risk. Small savers in particular are unlikely to make detailed analyses of the balance sheets of banks and finance houses. They must operate on the basis of a reasonably solid faith in the whole system. This is the reason for retaining some rules which ensure that individual financial institutions manage their asset structure and choice of business with suitable prudence; the central bank retains the duty of prudential surveillance and continues to be the lender of the last resort. Of course, in the medium and longer term, it is desirable that inefficient institutions either close down or have their activities taken over by more efficient managers, and excessive regulation inhibits this.

The labour market is inherently different from most product and financial markets. It entails long-term (either explicit or implicit), contractual obligations. People have a high weighting of security preference in employment due to family dependency and other reasons. Moreover, the taking up of new opportunities is sometimes contingent on a very high level of underlying skill and experience, and possibly the existence of entirely new skills. These may be in short supply for a number of reasons, and correction of fundamental skills shortages can often be addressed only in a long-term horizon. For these reasons enhancing the ability of labour to adjust as product and financial markets change may require a more imaginative

approach to policy. It is clear that a good deal of regulation affects the way the labour market works and adjusts, and, as with other areas, it would be surprising if the mechanisms which have built up around it are appropriate to contemporary needs. Nevertheless, we should be wary of the way reform is approached. Whether some form of intervention is desirable regarding the appropriate supply of skills for the medium term is a very important policy question and one which the Monitoring Group proposes to take up separately.

Safety and Health Regulation

Safety and health issues clearly motivate much regulation. Because of information problems inherent in many health and safety issues, and because of the extent to which third parties not involved in transactions are affected, it is difficult to envisage a situation where society can avoid regulating in this area. Moreover, there are situations where regulation helps market participants get desired safety and health outcomes. For example, relative imbalances in bargaining power (say if employees are exposed to danger at work) may be reduced by regulation. Alternatively there are many situations where transaction costs would be very high without regulation (e.g. ascertaining whether an electrical appliance is insulated appropriately). The main economic concern is that a sufficient improvement in safety is provided, given any costs regulation might bring with it. Secondly, it is desirable that any regulation implemented minimises economic costs, irrespective of the importance of the safety issues being addressed. Much occupational entry restriction as well as product quality, input and labour restrictions, information requirements and conditions of service are rationalised as safety protection. A rough count suggests that about two-thirds of the Acts examined by the Monitoring Group contain provisions with restrictions of this kind. It follows that health and safety policies warrant careful scrutiny.

The issues surrounding regulation for safety, and the form it should take, are complex ones. Whether there is a need to regulate at all hinges on the risks which certain activities contain for causing harm in relation to the costs of taking precautions. If certain practices or activities have the potential to cause serious accidents or health problems, stringent restrictions are likely to be justified, even if quite high costs result. The balancing of cost against potential harm is a necessary requirement, not a sufficient one. The knowledge which exists about such risks and costs should also be considered carefully.

Intervention is warranted if any of the relevant parties are unaware of substantial risks of harm occurring. This is especially so if the harm would be suffered by parties other than those whose actions cause the damage. Precautions will generally not be taken if the private costs of doing so are not matched by any expected

⁷ These studies, made available to the Economic Monitoring Group, are not published, but exist in the form of working papers.

⁸ It may be noted that the case for compulsory unionism is also based largely on a free rider type of argument.

private gains from avoiding harmful events. The most obvious case is when the injury occurs to some other party. But it will also apply when the probability of an accident (even a potentially very serious one) is considered to be very low or if the effect of an accident is minor (even though it might occur frequently).

Much safety legislation concerns the protection of workers in industry. The issues surrounding safety legislation in workplaces illustrate many of the problems. The rationale for such regulation is usually some combination of the following elements:

- either employers or employees do not understand the risks of injury
- the employer is thought not to be concerned about the risk to employees (this suggests, among other things, that replacement labour is easily hired if the injured party is unable to continue working)
- the employee is not in a position to bargain effectively for safety procedures (sometimes legislation might be seen as the result of a bargaining procedure whereby employees collectively, i.e. through a trade union, convince government to provide conditions that the employers are unwilling to consider).

There are, in simple terms, two possible policy approaches:

1. to regulate, i.e. to define and enforce minimum standards of precautionary care; or
2. to establish compensation rights and liability for harm, i.e. to legislate so as to define who is responsible for any compensation or loss, and to indicate the amount and form (usually financial) compensation to injured parties should take.

Although some accidents are reversible in the sense that the existing state of affairs can be re-established, albeit at a cost (e.g. damage to property, time off work), there are others (e.g. death, serious personal injury, environmental damage) that are not. In this latter case, the compensation principle is of much value only if its effect is to increase incentives to avoid accidents. There are circumstances in which the payment of even very large financial amounts do not adequately compensate real losses. In some of these, the financial liability may exceed the assets of the responsible party, thus making compensation impracticable irrespective of the legal position or the real measure of losses.

There are, however, many cases where the compensation approach adequately deals with the issue, and is therefore to be preferred, because it is less rigid. A regulation based on the average case will mean careful workers are over-regulated (imposing either unnecessary costs on the employer or reduced wages to careful workers) and others will operate in circumstances of excessive risk. The compensation approach gives managers greater flexibility in adopting safety measures more suited to the

real risk, rather than the risk which is visualised and defined by the law-drafters. The best solution may often be a combination of regulation (i.e. to cover a minimum outcome much below the average), and compensation designed to increase incentives for safety. It is to be noted that the compensation approach, as opposed to the more inflexible fixed rules approach, is likely to be less successful where events of a catastrophic character are likely (e.g. where death is a strong possibility), unless the penalties of accident are extremely high. Even then, the effect on behaviour may lead to costs of accident avoidance not unlike those of rigid regulation.

Safety regulation issues are sometimes clouded by a tendency to focus on accident probabilities when the real problem is information efficiency. Accident frequency is not always the barometer by which the need to regulate is judged. The logic of this is suggested in the following quotation:

*"Contrasting the market for kitchen knives with the market for baby cribs illustrates this distinction. In the first example, the risk associated with using knives is that of the user accidentally slicing his fingers. Nevertheless, many consumers are observed to willingly bear this risk by using knives. They prefer the combination of product use with risk, to no use and no risk. In the second example, however, the risk associated with product use was not well known. Until the National Commission on Product Safety dramatised this example, nearly one hundred babies choked to death each year by sliding through the slates of cribs in anomalous fashion. Yet this frequency was so low that no two were ever brought to the same emergency room. Indeed, every occurrence was considered a fluke until the stable but low frequency throughout the entire population was discovered. The first example illustrates a product for which there is no safety problem despite the frequency of accidents; the second illustration demonstrates the safety problem for a product with a low frequency of events."*⁹

The point to be drawn from this is that accidents may be a problem only if the public is not well informed about the likelihood that they might occur, or circumstances conducive to accidents. A known risk is one which can be avoided if an individual is of a mind to do so. Clearly there is a case for using public resources to improve information about accident probabilities and causes if the costs when an accident occurs are known to be high. Very many cases involve less clear-cut trade-offs than are implied in the quoted example. Who is to say on what basis road accidents, cot deaths, swimming pool drownings or an earthquake disaster should compete for public resources:

⁹ Weingast, B.R., McBride, E., Conant, J.L., *Product Safety and Consumer Information: The Impact of Liability Assignment and Standards Regulation*, Working Paper No. 45, Center for the Study of American Business, Washington University, Missouri, June 1979

- (a) to research the probability of tragedy; and
- (b) to explore mechanisms of prevention?

In the final analysis, "public opinion" will determine these sorts of priorities. But if the authorities who decide specific resource allocations act on the principle that accident cost and information enhancement should determine their priorities, rather than accident frequency, better social outcomes for less economic cost become more likely. Improved information brings with it the added possibility that private insurance markets can provide appropriate risk-minimising options without further regulation being necessary.

Some useful studies have been published examining safety legislation in New Zealand. These indicate a mixed picture, suggesting areas of improvement, but also indicating that there are some worthwhile features as well. They are discussed in more detail in the Appendix.

Environmental Protection Legislation

Protecting the environment is a significant source of regulation. In principle it is similar to safety regulation in the way it operates, but the fact that it tends to be concerned with physical environs rather than people means that the structure and nature of problems associated with it are somewhat different. Most environmental legislation takes the form of input restrictions, but some production quotas and entry controls clearly have environmental implications. Also, compulsory levies can be used to fund environmental protection activities.

As with safety and health, it is difficult to see that environmental issues can be dealt with without regulation, and a similar choice between rigid forms of control and incentives built into legal liability rules arises. It is likely that strict regulation is appropriate more often than in other areas. The reason is that the critical problems requiring policy attention will often be ones in which the social costs involved are very large and often of an "all or nothing" character as far as the protagonists are concerned. Having said this, each case has to be considered on its merits. At this time it is not possible to lay down any rules of thumb regarding the form of regulation that should be used.

Social Legislation

The existence of social legislation inevitably leads to specific kinds of regulation. In large part this is because rules are needed to define input patterns, as there is no market as such. The Health Act and the Education Act are two major sources of such regulation. In other words, regulation is necessarily part and parcel of the provision of public goods.

The economic implications of social regulation run many different courses. For example, there are likely to be labour market effects. The pay, occupational scales, and working conditions in

major public sector institutions impact on related occupations in the private sector. Furthermore, the purchasing practices of public institutions have a significant bearing on private sector resource allocation. To the extent that public administrators seek best value for money when buying, the allocative effects of their decisions may not differ much from those in the private sector. However, to the extent that decisions are set in regulation, there may in effect be entry barriers to suppliers of goods and services not recognised in the legislation.

Each of these areas of regulatory intervention generates its own particular kinds of analysis problems and priorities for reform. It will also be quite clear that there are substantial overlaps between the areas suggested.

Enforcement of Moral Judgements

It is evident that some activities are regulated on the basis of moral judgements about the way they should be conducted, or whether they should be conducted at all. To take this to a pedantic extreme, we could say that murder and assault are outlawed on moral grounds, but these are not normally seen as activities having economic significance and this sort of regulation has not been considered in this report. The regulation of liquor manufacture and distribution is perhaps the clearest example where the moral intent of the legislature has significant economic effects. The Monitoring Group has, in fact, already referred to this as "economic regulation", although it might just as easily be included here.

Apart from this, there are a number of relatively minor industries which are subject to entry control, where the main rationalisation appears to be based on moral judgements. Examples are the staging of boxing and wrestling matches, private investigator and security guard business, establishment of a racing club, the running of games of chance, bookmaking (prohibited), the operation of massage parlours, and arms dealing.

The issues here are not major ones as far as the economy is concerned. It does however touch on a potential major topic for consideration, namely the informal economy (including illegal activity).

Issues to be Resolved

This exploratory investigation has left a large number of issues unresolved. It may be helpful, therefore, to spell out some of the next steps that it would be desirable to take regarding further study.

1. First, the picture of regulation is fixed in time. We have chosen the most recent period possible to provide this "snapshot" of the regulatory environment, but in the nature of things this is already superseded. In some areas, particularly that of financial regulation where the changes have been

swift and fundamental, our listing is of historical relevance only.

2. The classifications of market restrictions have been made judgementally and are clearly subject to some error. This is highlighted by the relative haste which was necessary in order to provide material for the broad overview the Monitoring Group was seeking.
3. The classifications themselves, even if correctly documented, fall short of what might be desired. Ideally some measurement of the degree of constraint is also needed if the effect of regulation and any economic distortion is to be assessed adequately. Some sort of cardinal index gauging the strength is needed. In practical terms, achieving this would be highly unlikely, but even some crude ordinal ranking (e.g. strong/medium/weak) would be enormously helpful.
4. Related to the above, our picture of regulation gives little guidance as to the size of the parts of the economy they affect. Clearly restrictions which affect large segments of the economy may warrant closer attention than ones impacting in relatively insignificant ones. A further stage in the research, therefore, would be to assign weights measuring the economic significance of regulation.
5. Estimates, even quite rough ones, arising out of (3) and (4) above would facilitate subsequent research, perhaps using economic models, to pinpoint critical bottlenecks in the economic structure which may be addressed through policies of regulation reform.
6. The impact of delegated authority — i.e. the economic influence of quangos, advisory boards, inspectors, licensing authorities, and so on — is an important aspect of the regulatory approach to policy which has barely been touched on in this report. Any research which illuminates how such people and institutions behave is likely to

be valuable in assessing the effects which certain types of regulation actually have.

7. The approach taken highlights regulations as more or less isolated and self-contained policy instruments which, taken together, have an essentially additive economic impact. This, of course, is a gross oversimplification. Although the Monitoring Group has to some extent been able to illustrate that different forms of restriction tend to come in bunches, it has not paid much attention to the fact that there is likely to be significant interdependence between apparently quite separate pieces of regulation. The possibilities for policy inconsistencies and unintended side effects are much more difficult to disentangle than the additive framework tends to suggest.
8. If regulation serves useful social and economic functions it can do so only if it is in fact structured or designed in an appropriate way. This is a largely neglected area of study. Obviously regulation restricts choices, but questions remain as to how this might most meaningfully be approached. One concept is to regulate in a way which makes a certain outcome specific, leaving it largely to operators' discretion to achieve that outcome. Another approach is to seek a particular type of outcome by rigidly defining the process. This to a large extent is the choice between input and output regulation types in our classification system.

There are no clear-cut principles which make it easy to declare what is preferable. Each has advantages and disadvantages. Regulating the outcome is attractive in that it makes clear what is wanted but allows flexibility with regard to achieving it, and is therefore likely to be associated with input resource efficiency. However, this system puts the pressure on satisfactory specification of the outcome as well as assuming that acceptably cheap measurement and inspection facilities are available. Regulating the process rather than the outcome is in many cases simpler to administer. However, it obviously runs the risk that the process set down is excessively costly or not well adapted to the outcome desired.

Conclusions

Regulatory policies impact on the economy in diverse and complex ways. Many of these effects are unintended and, moreover, unseen. There are costs associated with these side effects, so there are very real dangers that regulations achieve their immediate goals only at a much higher cost to society than is really warranted. There is an obvious need for review and reform of regulation. Anything which makes the overall process of regulating more transparent is likely to make the rules match social and economic objectives with greater effect.

It is, however, naive to think of a world without regulation. Any over-enthusiastic pursuit of "deregulation" without careful attention to the kinds of rules best suited to contemporary needs runs little chance of improving things. It seems that some regulation, particularly in the economic field, is quite unnecessary and could be removed altogether to let the market operate properly. But cases as clean-cut as this are, perhaps surprisingly, few and far between. The more usual case is that, while regulation is rather cumbersome, and frustrates the operation of useful market mechanisms, it cannot be eliminated entirely. In this instance, various combinations of reform — review, simplification, or updating — are appropriate, rather than abolition.

The current predicament of the New Zealand economy merely serves to highlight the desirability of urgent attention to this area of policy. This is now widely appreciated and over the last year we have witnessed a dramatic redirection of economic policy. The Monitoring Group supports the broad thrust of this, particularly the planned reduction in the public sector deficit and the shift of emphasis away from protectionism. Inappropriate regulations are likely to be an additional source of unnecessarily costly protection to some activities, and removing them is therefore a potential source of better resource allocation. However, the very sharpness of the pressure which policy change has brought on adjustment mechanisms throws up another set of policy problems. The regulatory environment is a pivotal part of the economy's reorganising capability and some concentration in this area would be particularly useful.

It is impossible to judge with any precision whether in New Zealand we are more or less attracted to regulatory options than is typical in countries with similar economies. It is certainly the case that substantial areas of the economy are subject to the rigidities of regulation, which is something we cannot afford to be complacent about. Some of the more ob-

vious areas where there are reform options can be tentatively suggested.

The labour market is one of the most obvious areas where some detailed further study is needed. Labour legislation setting remuneration rates, conditions, demarcation and other matters underpins much of the economic system. Under various Acts there exists a multitude of specific regulations which are the major determining influence in money (but not necessarily real) wages throughout the economy. This regulation heavily influences any market forces which might, if regulated differently, lead to different wage structures and employment patterns. The way this should be managed, the form it should take, or even whether it should exist at all, is profoundly important to the way the economy operates. Simplistic economic models and the tendency to offer sloganistic suggestions do not help the process of reform. However the highly politicised and sometimes emotive nature of labour and employment issues makes both hard to escape. The Monitoring Group is currently turning its attention to this area.

The general area of agricultural processing and marketing is an obvious candidate for reform given its central importance in the economic structure and the extent to which it is affected by regulation, including health regulations imposed by our trading partners. This area has not, of course, been neglected by analysts and policy-makers. Both our recent and more distant past are littered with reports, committees, and policy action affecting the meat, wool, dairy and other primary industries. The Monitoring Group's view is that it may be timely to take a step backwards from all this and reconsider the philosophies and the overall principles which underpin our approach in this sector. Entry restriction is clearly at the heart of the matter. This brings with it obvious problems, especially in a world in which the predominantly commodity trading character of agriculture has largely disappeared. But it is argued with some conviction by many that it is this very change which heightens the need for marketing structures which are able to take the longer view and adopt a more developmental approach. There is little regulation of entry at the land use stage, some local authority zoning notwithstanding, but prices and quality are extensively regulated, and this may have a substantial influence on resource use. On the other hand, the scale and risks of investment in primary production warrant efficient marketing structures which not only provide primary products with appropriate distribution but are capable of

sending back meaningful signals to primary investors. The Monitoring Group acknowledges that certain regulatory approaches may have beneficial effects in this respect. The small scale of most land use enterprise in relation to processing and marketing, plus the advantages for a small exporting country of adopting a national corporate image are among the reasons for this. However, an appropriate mechanism for entry is needed because there are few reasons to suppose that all worthwhile innovations arise within the incumbent organisations.

There are clearly other industries, particularly ones involving severe entry restriction, which warrant major reappraisal. Many of these involve the state trading segment of the economy. The Monitoring Group is encouraged by the reforms which have already been introduced in some sectors such as the transport sector and the financial sector where preliminary evidence suggests they are bringing desirable effects. It seems likely that the environment of acceptance for reconsideration of deeply entrenched regulation is enhanced by these developments.

In the complicated areas of safety and health regulation, environmental planning, and information requirements, there is always a case for reviewing what is in place.

The measurement and appraisal of social costs and benefits is central to many of the suggestions made by the Monitoring Group. We must be prepared to use the concepts of cost-benefit analysis to weigh judgements. But at the same time we need to acknowledge the intractability of accurate measurement which cannot be perfected. In this respect it is opportune to repeat the insight that there is more to be said for rough estimates of the precise concept than for precise estimates of economically irrelevant concepts. The "shopping list" detailed in Chapter 4 may therefore be overly ambitious. Nevertheless, an intensified programme of research in many of these areas is feasible.

On-going Procedures for Reviewing Regulation

The regulatory environment is an important element in the process of economic change. The policy issues which stem from this depend on the answers to the questions: "Do regulations which impede adjustment serve any useful social purpose?" "Do they serve it in the most effective way?" "If they don't, does this mean that the regulations should be changed, or that the macro-strategy is inconsistent with the regulatory and other aspects of the micro environment?"

The possibility that the political system is vulnerable to manipulation by parties which do not fairly represent a balance of society's interests must be taken seriously, despite the difficulty of proof. If lobbying of various kinds is the main sculptor of regulation, it becomes impor-

tant to understand why economic interests would seek a political solution to business problems rather than a commercial one. It takes resources to lobby just as it does to do marketing research, discover new technologies or carry out time and motion studies.

There are no satisfactory answers to this question. It seems plausible that it may depend on the political environment — the extent to which officials and government might be sensitive to certain types of problems. Alternatively it may be a more attractive option in certain types of industries (for example, where entry costs are low, and regulation offers the best chance of restricting competition).

By its very nature, regulation is put in place on a case-by-case basis. Moreover, because of the extensive process of debate and legislative procedure that goes before it, the regulatory structure is often slow to change with underlying circumstances.

One consequence of this is that its role as an economic control mechanism tends to change, even though the details of the control structure do not. As this happens, new reasons emerge to provide political support for the regulations. Part of this is the result of market participants adapting to the regulation. Closely allied to this, businesses which have successfully adapted to, or found a niche in, a regulatory environment, see the regulations, probably correctly, as the foundation of their economic base. Naturally this can lead them to resist extensive modification. Of course, it will not always be possible to argue the case in such a direct fashion. Fire safety procedures can convincingly be recommended in terms of some fire risk only, not to provide employment for fire inspectors. (This would patently be as silly as to recommend the removal of fire prevention regulations on the grounds that as a result there would be enough fires to keep the Fire Service occupied.) But the introduction of fire-resistant building materials for example, is likely to result in different priorities, because the risk of fire, and hence the need for fire fighting services, is affected. Such a development would result in quite different alliances of the interest groups arguing for the continuing regulations. The historical evolution of regulation and the associated changes in the supply and demand for particular activities are extremely important aspects of understanding its impact.

Reassessment and reform are on-going needs. By its very nature regulation results in fixed and often rather arbitrary rules. These rules are set in relation to contemporary problems and events which quickly become past problems and past events. Over time things change. Greater use of roll-over reviews and sunset clauses in legislation would probably improve this situation. But appropriate mechanisms to address the issues raised in this report have by and large not been available in New Zealand, and the Monitoring Group strongly favours the establishment of a review body with a mandate

and the resources to examine and comment on regulatory structures. Exactly what the body's agenda should be and who should determine it would be resolved by a process of public debate, and would require a fuller proposal than we have at this point put together.

However, its function would be to heighten the transparency of the effects of legislation on economic and social affairs. It is highly desirable that when regulations are introduced, what is happening is apparent to both the public and the legislators.

and Safety Issues in New Zealand

Cullen, R. The regulation of safety and health in New Zealand. Department of Labour, Wellington, 1984. 100 pp. \$12.00. ISBN 0-478-21000-0.

Cullen's paper considers regulation of availability and use of new therapeutic drugs. It starts by pointing out the risks between the risk of adverse reactions, and the availability of new pharmaceutical products, and of losses to society's health and safety. It then discusses the availability of new products. The argument for regulation is based on the fact that the health care system is not perfect, and that doctors who prescribe drugs are not always the best choice. Mention is made of the general level of research and development in the United States which has a 10% health care budget, and the fact that the introduction of new products that have the potential for harm is not controlled.

The paper compares the United States and New Zealand regulatory systems. It points out that the United States has a more extensive regulatory system, and that the New Zealand system is less extensive. The characteristics of the two systems are quite different. In the United States, a drug is not marketed until it has been approved by the Food and Drug Administration. In New Zealand, a drug is marketed as soon as it is available, and the Ministry of Health is responsible for monitoring its safety. The Ministry of Health is heavily dependent on the pharmaceutical industry for information, and the Ministry of Health is not always the best choice to monitor the safety of drugs.

It is not entirely clear whether this is the reason for the adverse effects of drugs. It is pointed out, for example, that the Ministry of Health has a more extensive regulatory system than the United States, but that the United States has a more extensive regulatory system. It is also pointed out that the Ministry of Health is heavily dependent on the pharmaceutical industry for information, and that the Ministry of Health is not always the best choice to monitor the safety of drugs. It is noted that both the Food and Drug Administration and the Ministry of Health have a similar role, and that the Ministry of Health is not always the best choice to monitor the safety of drugs.

What is not clear from Cullen's excellent paper is why there is a difference between the United States and the United States. While being gratified at what the Ministry of Health has done, the Monitoring Group is deeply concerned to conclude that the Ministry of Health is not always the best choice to monitor the safety of drugs.

See also: Cullen, R. The Economics of Farm Accidents and Safety. Department of Labour, Wellington, 1984. 100 pp. \$12.00. ISBN 0-478-21000-0.

The paper is an attempt to identify the main information problems in the context of farm accidents. It starts by pointing out that the current system of farm accidents is not always the best choice to monitor the safety of drugs. It then discusses the information problems in the context of farm accidents. It points out that the current system of farm accidents is not always the best choice to monitor the safety of drugs. It then discusses the information problems in the context of farm accidents. It points out that the current system of farm accidents is not always the best choice to monitor the safety of drugs.

— uncertainty
— loss of income (e.g. time, production lost)
— incurred costs (e.g. research diverted from other uses)

The nature of costs under different compensation programmes is discussed. It is pointed out that the current system of farm accidents is not always the best choice to monitor the safety of drugs. It then discusses the information problems in the context of farm accidents. It points out that the current system of farm accidents is not always the best choice to monitor the safety of drugs. It then discusses the information problems in the context of farm accidents. It points out that the current system of farm accidents is not always the best choice to monitor the safety of drugs.

Review of some research on health and safety issues in New Zealand

Cullen, R., *The Regulation of Availability and Use of New Zealand Therapeutic Drugs: A USA/New Zealand Comparison*, Economics Discussion Paper No. 8202, University of Otago, August 1982

Cullen's paper considers regulation of availability and use of new therapeutic drugs. The issues are classic. A dilemma exists between the risk of adverse reactions through the over-hasty introduction of new pharmaceutical products, and of losses to society's standard of health through excessive delay in the availability of new products. The argument for regulation hinges on the assumption that consumers and their agents (i.e. doctors who prescribe drugs) lack either the information or the ability to make the best choices. Mention is made of the ground swell of research and opinion in the United States which has it that the health of the public suffers much more from over-cautious introduction of new products, than from the harmful side reactions.

The paper compares the United States and New Zealand regulation of therapeutic drugs in some depth, and comes to the conclusion that the New Zealand system of regulating drugs is markedly superior. The characteristics of the two systems are quite different. In the United States, there is stringent control of the introduction of new drugs, but once introduced there is little regulation of use. In New Zealand, the procedures for introducing drugs, while certainly regulated, appear to be much more flexible, but the prescription of drugs is heavily regulated through the existence of the Drug Tariff, a set of rules managed by the Pharmacology and Therapeutics Advisory Committee.

It is not entirely clear whether this is the reason for the advantages in the New Zealand system. It is pointed out, for example, that New Zealand has a more effective system of collecting information about adverse reactions. Possibly this is because of the relative obsession in the United States with pre-introduction testing with the result that post-introduction review is not thought necessary. Perhaps of greater significance is the existence of a clear cost-benefit philosophy in the relevant New Zealand legislation. In particular it is noted that both the Food and Drug Act 1968 and the Medicines Act 1981 which replaced it, directed the Minister to "*weigh the likely therapeutic value of the drug against the risk, if any, of the use of the drug injuriously affecting the health of any person*".

What is not clear from Cullen's excellent paper is why these things evolved in different ways in New Zealand and the United States. While being gratified at seeing some evidence that this particular problem has been dealt with here than somewhere else, the Monitoring Group is clearly unable to conclude that this may be common to other New Zealand regulation.

Leathers, K. L. and Williams, J. D., *The Economics of Farm Accidents and Safety in New Zealand Agriculture*, Research Report No. 154, Agricultural Economics Research Unit, Lincoln College, May 1984

This study is an example of the way analytical and information problems may be approached. It lays out a clear set of guidelines for the identification of relevant costs and benefits associated with different systems of compensating accident victims, and considers the economics of farm safety programmes using a "cost effectiveness" framework. "*Farm safety programmes are aimed at prevention, and it is in the public interest that expenditures on safety are closely associated with the expected benefits.*" The study is useful, firstly in its detailed, but practical, specification of what should be counted. It identifies four sources of social cost:

- uncertainty
- suffering
- direct loss of income (e.g. time, production lost)
- indirect costs (e.g. resources diverted from other uses)

The nature of costs under different compensation and accident safety programmes is considered. Secondly it provides guidance regarding the measurement of costs. Although the authors are rather cautious in drawing explicit policy implications, there is rather strong evidence that a very large number of farm accidents do not involve high social costs. The current approach of preventative education would appear to be adequate. It may even be more than necessary. Nevertheless, there is a narrow band of relatively serious accidents (20 percent of the total) which accounts for most of the social costs (70 percent). Despite the estimate, therefore, that the Accident Compensation Corporation pays out more in actual compensation than the (admittedly rough) estimate of social cost, there is evidence of a fringe which experiences significant uncompensated costs. Clearly this

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indicates some priorities for research into the cause of accidents, accident prevention programmes, and compensation mechanisms.

Walker, I. K., *Occupation Safety: An Inquiry Into the Coordination of Legislation on Industrial Safety, Health and Welfare*, State Services Commission, 1980

This study attempts a stocktaking of occupational safety regulation in New Zealand with recommendations to "rationalise and consolidate enactments". While the issue is usefully discussed within a framework of cost effectiveness, little consideration is given to the overall regulation debate. In the context of our discussion above, it is clear that New Zealand safety legislation is largely a regulatory approach rather than one of defining rights and liability. The discussion, therefore, is primarily in terms of the efficiency of the regulations which exist, rather than on whether the whole approach to regulating for safety might be changed. Nevertheless the role of information is stressed in a number of ways. Some favour is expressed for the possibility of accumulating administrative responsibility into a single department, although suitable warnings are lodged that the benefits of this may sometimes be less than they seem.