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Risk-analysis and risk focus in technical regulations – a comparison of approaches

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Disasters in the news – is « more stringent regulation » the right response?

- Disasters often lead to calls for more / stricter regulation – without first investigating whether existing regulation was properly *enforced* – and whether the problem can actually be entirely solved / prevented through regulation…

- The goal would rather be to find a regulatory system that is optimal in terms of adequation to risks, and of enforcement

- Look at respective merits of “more prescriptive” vs. “performance-based” approaches to technical regulations

- Analytical tool: notion of “risk” and its different meanings, i.e. the different risks that each approach is best at addressing, and the trade-offs that are involved

« Prescriptive » vs. « Performance Based »

- The choice between these two approaches is partly a function of the nature of standards:
  - Imposed by the regulator(s) to all enterprises or
  - Developed by enterprises (and other stakeholders) and (more or less) “endorsed” by regulators

  - Very specific in the materials, amounts, methods etc. or
  - More flexible and prescribing rather characteristics for the end result

- Each approach has different strengths, i.e. is better at dealing with different types of risks

What risk(s) are meant here?

- General formula: [risk level = probability x magnitude]
- But this says little about the content of the risk :
  1. incompatibility of goods/techniques resulting in economic loss
  2. hazards for life/health – of workers, of consumers etc. – and for environment
  3. fraud against consumers [product information not truthful]
  4. theft/evasion [theft of inputs, tax evasion…]
- Not all risks are concerns for the same actors – some for the state [as “emanation” of consumers/citizens, in particular], some for businesses
- In different regulatory systems, these risks can be given more or less priority, and be handled at different levels

« Risk adverse » vs. « Risk focused » approaches

- "Risk adverse": aims at preventing any [most] violation(s) and/or deviations from the norm – goal = 99.9% certainty

- "Risk focused": aims at optimizing the cost/effectiveness ratio, and at "maximal effectiveness in real conditions" [limited resources, market complexity, technological change etc.] – by:
  - Using a gradation of regulatory tools to deal with different levels (and types) of risks
  - Focusing resources on a limited number of goods or sectors identified as higher-risk
  - Accepting that some "failures" will occur – but building mechanisms to:
    1. Mitigate their effects
    2. Respond effectively to minimize risks of repeat accident
    3. Ensure compensation [through liability + insurance]

“Risk adverse” approaches: prescriptive requirements, *ex ante* controls

- Compliance can easily be verified by regulators and producers alike

- No goods to be produced/imported that do not meet the requirements

- Limits in reality:
  - might not cover issues/problems/risks that have not yet been detected – whereas performance-based requirements might be able to do so
  - require frequent updates/changes – which might be difficult for legislative reasons (or for trade reasons if regional standards etc.)
  - practical difficulties in checking/testing 100% of products 100% of the time – can slow down economy and/or give incentives to evasion – or simply 100% are not achieved, but without a proper targeting
  - innovation/technology adoption made more difficult if new technologies differ from established standard

Risk aversion can be economically problematic

- Reduced innovation / technology adoption – impossible or at least far costlier to introduce new approaches
- Reduced competition:
  - More difficult to introduce new products and thus differentiate from existing producers / incumbents
  - Prescriptive, specific national norms + 100% testing also make imports more difficult and costly => increased prices and reduced choice for businesses and consumers
  - Mandating use of older technologies, which are often costlier, can further decrease market entry
  - No difference in costs between high-risk and low-risk goods and producers
- Significant adverse impact on growth, innovation, consumers

Duplication of regulatory functions: useful additional safety measures, or excessive costs?

- Exist in all types of systems, and difficult to eliminate entirely anyway – but more frequent in prescriptive, risk-adverse ones:
  - Risk-aversion means that repeated controls of the same issues are often seen as additional safeguards against hazards
  - Prescriptive requirements often mean that there are repeated occasions when market agents have to prove compliance
- Duplication increases costs – and can decrease effectiveness:
  - Regulatory budget expenses several times for the same purpose – and repeat compliance costs for businesses
  - Different regulators often mean different regulations for the same topic – creates confusion, “distraction” by rules complexity which does not allow to really focus on safety
  - Burdensome character makes compliance more difficult, which incentivizes firms to try and work in a “grey” way altogether – and also decreases overall credibility of regulatory system

Does « prescriptiveness » harm « regulatory credibility » - and thus, effectiveness?

• Very prescriptive, “risk adverse” requirements tend to set a very high bar => compliance is difficult to achieve, many producers may find it impossible

• If the “net is cast very wide”, market agents may find it simply impossible and/or irrelevant to have compliant goods, and start ignoring regulations

• A large coverage and complex procedures can mean that the regulators are overstretched – they cannot *really* check everything that they purport to

- This means many checks can end up happening “on paper only”
- Because this is not the result of conscious risk-focus, it can be that precisely high-risk goods “fall through the cracks”
- Credibility is harmed, because market agents see that the system is more “paper focused” than “risk focused” –as a result they see compliance not as a necessity for safety, but just as a burden

Flexible, risk-focused approaches have weaknesses too – how significant are they?

- Not easy to implement – requires private sector capacity, robust accreditation system, strong liability regime, and demanding consumers!
- Costs less visible but significant – technology upgrades, third-party certification, costs for consumer associations etc. which have a key role too
- Not necessarily "easier on business":
  - Additional uncertainty (mitigated by "deemed-to-comply" standards)
  - Emphasis on producer/supplier liability is not always welcome by them!
  - Credibility is harmed, because market agents see that the system is more "paper focused" than "risk focused" –as a result they see compliance not as a necessity for safety, but just as a burden
- Safety: better or worse?
  - In large part a function of development level rather than regulatory style
  - Key is generally how well any system is enforced
  - However considering their better economic record, risk-focused system appear to perform generally well on the safety side too

Can risk-focus help make gradual transformations instead of a « big bang »?

- Many countries trying to transition towards more “flexible” system because of international integration and economic growth goals
- Process can be difficult, costly, protracted – “big bang” approach often simply does not work (i.e. done “on paper”) – so where to start?
- Possibility: use a risk-focus approach rather than an “old/new” grid -
  - Sort out which products should remain more strictly regulated, and which ones could be less so
  - Introduce lighter conformity assessment for medium-risk goods, retain stricter conformity assessment for higher-risk ones
  - Allows to immediately reap benefits in terms of trade, innovation, competition – while leaving time for the institutional transformations
  - For specific high-risk goods, a country could decide to keep its more prescriptive system, if it has a moderate impact on external trade
  - In any event, a risk-based view of these changes opens the way to more flexibility rather than a “one size fits all” approach to change