

# THE QUALITY OF REGULATION. THE MYTH AND REALITY OF GOOD REGULATION TOOLS\*

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## *Abstract*

The objective of this paper is to introduce the main tools used to manage the flow and the stock of regulation with special attention to those based on economic analysis, their advantages and weak points, the consequences of their use in public sector organization, procedures and, in general, in the relationship between regulators and their targets. Discussion is also devoted to conditions for improving their efficacy, since the tools need to be used selectively, and require an agenda-setting phase as well as periodic retrospective analysis of existing rules as used in the whole regulation life cycle. Therefore, it is crucial to understand what these good regulation tools are really intended for, and to avoid their over or under-evaluation, both of which could be influential in reforms made partially or in name only. At the same time, their limits could incentivize the search for innovative solutions, such as a special attention to the real needs and behaviour of people in the design of new regulation, as well as in its measurement and reform.

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## 1. Introduction

The growing interest in good regulation has focused attention on the tools intended to reach this aim, considered as strategic step forward in growth and competitiveness of market economy countries. Nonetheless, it cannot be forgotten that good quality regulation is an essential element of the rule of law. Firstly, because it allows for widespread participation in public procedural decision-making. Secondly, it imposes a duty to give reasons for preferred policy options. And lastly, it helps end-users' comprehensibility and allows public targets to be met without unjustified costs for regulates and regulators. For these reasons, good quality regulation should be the object of constant attention from regulators and policy makers, and should not take on importance in economic crises alone.

There are different kinds of good quality regulation tools (as summarized in paragraph 5), which concern both the content of regulation (it must be necessary, proportional and consistent) and its form (a rule should be well written and accessible to end users). These two aspects concern the stock and the flow of regulation.

Before going into the merits of these tools, it should be stressed that their utility should not be over-emphasised. The first thing to be said is that tools used to improve the quality of regulation evolve over time and partially differ from one country to another. For instance, the exclusive attention to formal drafting and to "evaluation legislative" in the administrative law countries has been accompanied in recent times by an assessment of the impact of new regulations; moreover, in countries characterized by a great tradition in economic analysis these assessments have recently included a specific risk and competition assessment. Secondly, no individual tool can bring about the final objective of

good quality regulation on its own. Finally, they are not capable of solving the structural problems presented by a multiplicity of regulatory systems (i.e., the proliferation of regulatory structures, fragmentation and overlapping of responsibilities).

With such caveats in mind, it is crucial to understand what these good regulation tools are really intended for. In general, they are not decision-making methods, nor are they intended to substitute political choice with the results of algorithms or formulas. On the contrary, they can be used to raise the right questions to regulators: is the new regulation necessary? Is it proportional to its aim? Is it going to generate unintended consequences? Is it clear, consistent, comprehensible and accessible to users? Is the existing regulation still justified and needed for the future? Among the available good regulation tools, those based on economic analysis (such as Impact Assessment-IA and the Standard Cost Model-SCM) provide evidence of advantages and disadvantages of existing or new regulation while also allowing evidence-based decisions (paragraph 6 and 7). At the same time, the experiences and awareness of their limitations and incorrect uses can lead to these tools being used in response to a legal obligation in name only. As a consequence of these under-evaluations, time consuming and costly methods are used to no advantage.

The paper is organized as follows, paragraphs 1-3 provide some evidence about the convergence on the need for and the meaning of good regulation, including the recent importance given to citizens and consumers as end-users of regulation. Paragraphs 4 and 5 evidence that only rules (considered in this context as a subset of the regulation) can be measured by good regulation tools based on economic analysis and the importance of the maintenance of such rules in all their life-cycle. Paragraphs 6 and 7 analyse in depth two good regulation tools based on economic analysis, which are widely used around the world and whose introduction have had the most relevant consequences on rulemaking procedures and rules which were eventually adopted. Paragraph 8 suggests that good quality regulation should be viewed as a new public interest which (together with other components) allows specific public interest met by regulations to be attained. Paragraphs 9 and 10 suggest other conditions to improve the efficacy of good quality regulation tools based on

economic analysis and that they may evolve to better achieve its objectives (to improve residuality, proportionality, consistency and accessibility of regulation) giving more attention to the needs and behaviour of real people. Some of the possible directions for these changes are developed in the concluding paragraph.

## **2. The growing interest in good regulation**

In general, the intention of the tools to improve the flow and the stock of regulation is to achieve high quality, with the ultimate objective of improving competitiveness, consumer welfare and so called *securité juridique*. Indeed, regulatory uncertainty, which usually concerns the unpredictability of an organization's regulatory environment (connected to the uncertainty about the basic direction of the regulation, the measures needed to put it into action, the implementation process itself, and the interdependence between regulations), is increased by extremely complex and conflicting regulations or by regulations which are outmoded or ineffective.

The interest in good regulation is not new. This is an essential element of the rule of law [U. Karpen, *Law Drafting and the Legislative training course for law drafters*, L. Mader and C. Moll (ed.), *The Learning Legislator*, Nomos, 2006, 9] and is the "basis for liberty and prosperity" [Statute of International Association of Legislation]. As early as 1748, de Montesquieu declared that "les lois inutiles affaiblissent les lois nécessaires" [*De l'esprit des lois*, quoted by the French Conseil d'Etat in 2006, reaffirming his position against "la complexité croissante des normes qui menace l'état du droit"]. Indeed, a place governed through few but effective laws was considered in 1516 to be no more than an imaginary island country: Utopia, by Thomas Moore.

In the 1990s, good quality regulation was confirmed as one of the main objectives in E.U. countries due to the choice for a market economy, which led to liberalisation and simplification policies, even if different results were achieved. In the new century, this convergence has been reaffirmed thanks to a common vision of European and international institutions concerning the crucial role played by the regulatory framework in competitiveness, growth and employment performance of countries. For instance, according to the World Economic Forum,

the first pillar of competitiveness is the “legal and administrative framework within which individuals, firms, and governments interact to generate wealth” [*The Global Competitiveness Report 2011-2012*]. The same position can be found in the European Union, the World Bank, and OECD documents [European Commission, *White Paper on European Governance*, COM(2001) 428 fin.; Mandelkern Group on Better Regulation *final report* 2001; World Bank, *Easy of doing business* reports; OECD, *Reference Checklist for Regulatory Decision-Making* 1995, OECD, *Guiding Principles for Regulatory Quality and Performance* 2005, draft OECD, *Recommendation on Regulatory Policy and Governance* 2011].

Further, in the current economic crisis, the link between good quality regulation and competitiveness explains the reason for the renewed commitment to regulatory reform in most OECD countries, both at national and local level. For example, the impressive widespread adoption of the Standard Cost Model has been due to its success at freeing up those resources of citizens and firms which are devoted to the administrative burden, and which were being monetized using a quite simple method.

So, although we have seen that it is not new, calls for regulatory reform have often been an answer in times of economic distress. The Great Depression in the U.S. “led to an enormous expansion in the scope of public utility and common carrier regulation, and the “stagflation” (...) of the 1970s set the stage for the deregulation movement” [R.A. Posner, *Economic Analysis of Law*, Aspen Publishers, 2003, 380]. Similarly, Europe turned to better regulation policies in 2000 to remedy its sluggish economy [B.J. Wiener, *Better Regulation in Europe*, Duke Law School, Research Paper n. 130, 2006, 9-10]. At present, the European Commission points out that “the crisis has highlighted the need to address incomplete, ineffective, and underperforming regulatory measures and, in many cases, to do so urgently” [*Smart Regulation in the European Union*, COM(2010) 543 final]. In the U.S. too one of the current presidential priorities is to design regulations in a way that promotes the continuing recovery.

Whereas traditionally the main objective in regulatory reform was to improve the environment for firms, today equal importance is given to all the end users of regulation: citizens, employees, consumers, and businesses. In other words, the link between good quality regulation and competitiveness does not

mean that the main focus of regulatory reforms is only on business, as in the ever relevant warning of Francesco Carnelutti: “il diritto o è per la persona o non è” [*Certezza, autonomia, libertà, diritto*, «Il diritto dell’economia», 1956, 1185].

At European level, this evolution has led, for instance, to a revision of consultation procedures to improve citizen participation not only in the adoption, but even in the implementation and revision of rules (i.e., at all stages of the regulatory life cycle) [European Commission, *Smart Regulation in the European Union*, COM(2010)543 def.]. Recently, the implementation of the Smart Regulation agenda has been presented as one of the strategies for sustainable and inclusive growth (Europe 2020, COM(2010) 2020). At national level, all countries engaged in the reduction of administrative burdens for business through the SCM are now extending those activities to citizens [European Public Administration Network, *Learning Team Administrative Burdens for Citizens. Report on National Approaches*, 2009].

A comparable sensitivity to all end users seems to have emerged in the U.S., exemplified by the tendency (or at least the desire) to use Regulatory Impact Analysis “as a pragmatic tool for cataloguing, assessing, reassessing, and publicizing the human consequences of regulation”, and by the focus on how people really behave in order to improve the efficacy of regulations and by new emphasis on transparency and open government [C.R. Sunstein, *Humanizing Cost-Benefit Analysis*, *Administrative Law Review* Conference, February 17, 2010]. This is connected to an innovative, new approach to regulation, which “must protect public health, welfare, safety, and (...) environment while promoting economic growth, innovation, competitiveness, and job creation” [Executive Order 13563, January 18, 2011].

### **3. What does good regulation mean, and why are bad regulations so common?**

The above-mentioned substantial convergence on the need for good regulation, also characterizes the meaning of good regulation tools to perform better regulation.

Therefore, there are many definitions of good (or better) regulation [R. Baldwin, M. Cave and M. Lodge, *Understanding*

*Regulation. Theory, Strategy and Practice*, Oxford University Press, 2011, 25 ss.]. For instance, the OECD stressed that “better regulation means to adopt regulations that meet concrete quality standards, avoids unnecessary regulatory burdens and effectively meet clear objectives” [*Overcoming Barriers to Administrative Simplification Strategies: Guidance for Policy Makers*, 2009, 44]. The European Commission affirmed that better regulation involves a “more effective, efficient and transparent” regulatory system [communication, *Better Regulation for Growth and Jobs in the European Union*, COM(2005)97 def.]. Moreover, the regulatory system “must ensure that regulations are accessible, consistent, written in plain language, and easy to understand”, as stressed by the U.S. executive order adopted in January 2011.

The numerous definitions of good regulation can be summarized as follows: the regulation must be necessary (i.e., targeted), proportional (imposing only burdens proportionate to its aim), consistent, well written and accessible to end users. In short, good regulation allows public targets to be met without unjustified costs for enterprises and citizens and it concerns both the content of regulation and its form [Italian Council of State, 2004].

There are many advantages which spring from improving regulation, such as the reduction of red tape, i.e. the unnecessary regulatory burden [OECD, *From red tape to smart tape*, 2003]: *i*) innovation can be encouraged through efficiency gains, *ii*) entrepreneurship can be favoured by fewer administrative burdens, releasing resources otherwise devoted to red tape, and *iii*) governments can gain constituency by reducing administrative costs to businesses and citizens without consuming large resources [OECD, *Overcoming Barriers to Administrative Simplification Strategies. Guidance for Policy Makers*, 2009, 7]. Even if the first advantage remains unproven, these arguments might be of interest to all regulators, not least because they will make an undeniable impact. Therefore, if good regulation has a crucial role in growth and employment performance, why are poor regulations so universal?

In general, regulators tend not to consider (or even know) the costs of regulations. Indeed, they use regulation as an easy answer to problems (behaviour which increases regulatory inflation) [T. Ascarelli, *Certezza del diritto e autonomia delle parti nella*

*realtà giuridica*, «Il diritto dell'economia», 1956, 1238]. At the same time, administrative formalities benefit many parties, such as consultants (who sell services to help businesses and citizens to fulfil regulations) and incumbent firms (who want to reduce market entry). Moreover, the most common cause of poor regulation is the growth of government and the lack of coordination across multiple centres of regulatory production [G. Corso, *Perché la "complicazione"?*, «Nuove autonomie», n. 3-4, 325; R. Rose (ed.), *Challenge to Governance. Studies in Overloaded Politics*, Sage publications, 1980, 17 ss.], which leads to excessive and overlapping demands on end users [OECD, *Reviews of Regulatory Reform: Italy*, 2009, 288].

These problems are exceedingly difficult to address in a sustainable way and they require much more than marginal changes to a few procedures. However, a committed use of good regulation tools could help to tease out interests, impose the right incentives and help to limit unintended consequences of rules and outmoded regulations. It obviously cannot solve the structural problems, such as those concerning the proliferation of regulatory structures and the fragmentation of responsibilities.

#### **4. Which regulation is concerned with good regulation tools?**

Before conducting an in-depth analysis of some good regulation tools and their implications from an organizational and procedural point of view, it is important to define those regulations considered relevant to good regulation tools.

There is no generally accepted definition of regulation applicable to the very different regulatory systems around the world, and scholars have formulated different theories, which will not be dealt with in this paper. In fact, a broad definition of regulation seems the most coherent with the objective of good regulation tools, which is to improve the quality of all requirements set by public powers. To this end, the OECD definition is useful, which considers regulation to be "the diverse set of instruments by which governments set requirements on enterprises and citizens". Accordingly, "regulations include laws, formal and informal orders, and subordinate rules issued by all levels of government, and rules issued by non-governmental or



self-regulatory bodies to whom governments have delegated regulatory powers” [OECD, *Report on Regulatory Reform*, 1997].

Regulations which are general (because they are addressed to an undetermined number of subjects) must then be divided into rules and principles. In fact, a more specific analysis must distinguish between those regulations and the rules which might modify the end-users’ activity, production or organization. In other words, the core element of rules is the content which directly affects the end users (differently from principles, such as free competition, which must be applied by rules) [R. Dworkin, *Taking rights seriously*, Harvard University Press, 1977]. A rule is, for instance, the provision of competition “for” the markets in local public services (meaning competitive bidding). This concept of a rule is close to that of regulation as “the sustained and focused attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes which may involve a mechanism of standard-setting, information gathering and behaviour modification” [J. Black, *Critical Reflection on regulation*, Center for Analysis of Risk and Regulation. LSE, 2002, 20].

Only rules can be measured through Impact Assessment (such rules are the so-called policy options whose impacts are compared through IA) and the Standard Cost Model method (which measures the costs of the time needed to comply with a rule which imposes an information obligation, such as collection of relevant data and reporting to the designated authority). This approach has concrete consequences. For instance, Italian Impact Assessment reports often confuse the alternative policy options with the sources of laws (such as legislative decree or governmental regulations) so that they conclude that there are no alternatives to laws if a European directive is to be implemented.

## **5. The life cycle of regulation and tools to improve flow and stock of regulation**

The core elements which, together, make up good regulation (necessity, proportionality, consistency, and plain language drafting) seem to be universally recognised in OECD countries, thanks to EU liberalisation and better regulation policies (adopted respectively since 1990 and 2002) as well as the OECD

recommendation to regulators and its reports on regulatory reforms at national level.

Moreover, OECD countries agree on the need to perform a reduction of the regulation stock and to improve the flow of regulation at the same time. In fact, the vast majority of those governments have experimented for almost a decade with regulatory policy mixes that include simplification, reduction of administrative burdens, and impact assessment.

This is related to an approach to regulation as a cycle, in which “principles of good regulation are applied in initial decisions on new regulations and in continuing reviews throughout the life of the regulation” [OECD, *The OECD Report on Regulatory Reform: Synthesis*, 1997, 29-30].

This approach is one of the lessons of implementation research (begun in 1970 with the famous study by Pressman and Wildavsky: “Implementation. How Great Expectations in Washington are Dashed in Oakland”) which eliminated the line of demarcation between adoption-implementation of public policies. At present, it is generally recognised that regulation must be managed throughout its whole life cycle: from the design of a piece of legislation, to implementation, enforcement, evaluation and revision. The attention to the regulation life cycle (derived from the public policy life cycle) marks the switch from better regulation to smart regulation at European level: smart regulation policy attaches great importance not only to the flow of new regulation, but even to the maintenance of the stock [European Commission, *Smart regulation in Europe*, 2010]. At the same time, in the U.S., the E.O. *Improving Regulation and Regulatory Review* (2011) specified the previous orders requiring each federal agency to submit to the Office of Information and Regulatory Affairs a plan concerning the periodic review of its existing significant regulations “to determine whether any such regulations should be modified, streamlined, expanded, or repealed”.

Although subject to change over time, the core elements for better regulation to improve design of new regulations (the flow) are currently the following:

- *Impact assessment* analysis (or Regulatory Impact Assessment) provides evidence for decision-makers on the advantages and disadvantages of feasible policy options by assessing their potential economic, social and environmental

impacts, including a specific assessment of administrative burdens and of competition (this topic will be dealt with in paragraph 7). This analysis has also to provide a broad outline of monitoring and possible *ex post* evaluation (for instance, the project of regulation can identify how and when costs will be checked and by whom).

- *Plain language drafting* (or the *legistique formelle*) ensures clear, consistent and accessible regulation. For instance, it imposes the use of unambiguous language and of explicit rather than implicit abrogation (e.g. “all the rules inconsistent with the new regulation are repealed”); or that any rules adopted by reference should be specified.

Impact assessment and drafting are specific tools which address the two aspects of good regulation: the formal and the substantive ones.

The target to simplify and modernize existing regulations (the stock) could be attained through:

- *Monitoring* activity, which provides information about whether rules are achieving their objectives and compliance is attained, and *ex post evaluation* (also called *ex post* impact assessment analysis), which examines the real impact of a rule. In fact, the impact of regulations should only be estimated in advance and the final effect depends on how a rule will be implemented, enforced, interpreted and sanctioned. These analyses can lead to a *revision* of regulation which is no longer necessary or proportional.

- *Administrative burden reduction* measured through the Standard Cost Model which is intended to quantify the cost of the time needed to accomplish an information obligation by the end-users of a specific regulation (this method will be addressed again in paragraph 6).

- The *Guillotine system* to reduce regulation aims at taking an inventory of the whole regulatory stock and eliminating unneeded regulations and simplifying remaining regulations (introduced in Italy in 2005 for repealing State legislation). It implies a variously sophisticated analysis of the stock through review criteria, such as: legality; necessity; efficiency; market-friendliness; and administrative cost recovery. In the first step of the Guillotine system the government counts all regulations affecting end users which are no longer justified or needed for the

future (each rule is reviewed against simple filters in a checklist format: Is it legal? Is it needed? Is it business/consumer friendly?). Then all regulations that are not needed are eliminated. Finally, all remaining regulations must be organized into codes and simplified. In fact, the Guillotine is almost never the end of reform (because the reduction of regulation is not an objective in itself) and theoretically prepares the ground for the normal use of good regulation tools in the regulation life cycle. On the other hand, there is the *sunset clause*, which introduces a future expiration date for a regulation in the text of the regulation itself [UK Department for Business, Innovation and Skills, *Sunsettings Regulations: Guidance*, 2011].

- *Codification* is usually considered as intending to repeal regulations and replacing them with a single new act, the code, which may unify existing acts (so called *à droit constant*, as in the France tradition) or introduce simplifications and other substantive changes. Common law states have put in motion a different process to codify, which is intended to unite up to date laws and regulations in a single act, without replacing the original texts (for instance, the U.S. Code and the UK consolidation statutes) [B.G. Mattarella, *La trappola delle leggi. Molte, oscure, complicate*, Il Mulino, 2011, p. 151 ss.].

- *Administrative simplification* is a very common tool to reduce red tape which imposes unjustified burdens on citizens, businesses and public administrations. It can be realized through “horizontal” measures (such as one-stop shops, or the replacement of authorizations with simple notifications to the public administration), or a procedure-by-procedure simplification (for instance, streamlining or reducing the necessary steps or imposing a time limit on the provision of an answer). The analytical second approach (suggested by the European directive on services in the internal market) is the one with the greatest chance of success. Administrative simplification could be one of the feasible policy options suggested in the impact assessment process, or the reform adopted after an administrative burden measurement through the SCM. The coexistence of simplification which has been approved after a costly and time consuming assessment alongside proposals which have been formulated without any in-depth analysis suggests the need for a ‘reform agenda’ to ensure that the

regulation submitted to the first or the second method are chosen consciously (as stressed in paragraph 9).

Paragraphs 6 and 7 return to the tools designed to improve the flow and stock based on economic analysis, ones which are widely used around the world, and whose introduction could have the most relevant consequences for the organization of regulators and their decision making procedures.

### **6. Simplification of burdensome paperwork requirements**

One of the core elements which makes up good regulation is proportionality: public targets must be met without unjustified costs for end users. This is the reason why good regulation involves cutting red tape originating from excessive regulation [OECD 2009]. Therefore, burdensome paperwork requirements which impose large costs on the private and public sectors, have unintended adverse effects, and reduce compliance [OIRA, *Disclosure and Simplification as Regulatory Tools*, June 18, 2010].

In the US, the Paperwork Reduction Act 1980 requires federal agencies to justify a request for information, certifying that it is necessary for the proper performance of agency functions, it avoids unnecessary duplication, it uses plain, coherent, and unambiguous terminology, the respondents are informed of the reason why the information is being collected, its use, its burden estimation (and the request has been developed by an office which has planned and allocated resources for the efficient and effective management and use of the information to be collected). In line with these provisions, in 2010 an Office of Information and Regulatory Affairs guideline asked agencies “to reduce such requirements by eliminating unnecessary, ambiguous, excessive, and redundant questions; by permitting electronic filing (including electronic signatures); by allowing “prepopulation” of forms, where appropriate and feasible by sharing information across offices or agencies; and by promoting administrative simplification by coordinating and reducing requirements from multiple offices and agencies” [*Disclosure and Simplification as Regulatory Tools*, June 18, 2010].

The above mentioned simplifications are suggested by the Standard Cost Model (SCM) mechanism as tools to reduce administrative burdens (the information obligations that would

not be collected by business or citizens without legal requirements) which have been previously monetized multiplying the time needed to reply to an information obligation by the hourly cost of people performing administrative activities.

Initially developed in the Netherlands, the SCM is at present the most widely applied methodology for measuring administrative costs in OECD countries. At European and national levels multiyear administrative burden measurement and reduction programmes to reduce costs and burdens by at least 25% by 2012 have been established [2007 Spring European Council]. The EU-SCM method was introduced, in 2006, then tested through the “Pilot project on Administrative burdens” and the “Action Programme”, and is now included in appendix X of the 2009 *Impact Assessment Guidelines*. The European Commission has completed a “Fast Track Action” of measurements (outsourced to an external consultant) of 42 EC regulations concerning 13 priority areas (company law, pharmaceutical legislation, working environment/employment relations, tax law-VAT, statistics, agriculture and agricultural subsidies, food safety, transport, fisheries, financial services, environment, cohesion policy, public procurement). Since 2009, the EC has extended the measurement to numerous other European regulations and is now adopting measures to simplify regulations (COM(2009) 544 final).

In Italy, the administrative burden measurement and reduction programme (the so called *taglia-oneri*) was introduced by the law 133/2008, aiming at reducing the same above mentioned percentage of administrative costs coming from Italian regulation (adopted at national, regional or local level), which the European Commission estimated burdened Italian enterprises by an amount equalling 4.6% of Gross Domestic Product [OECD, *Modernising the Public Administration. A Study on Italy*, 2010]. Many Italian Regions are currently testing this method, which is now mandatory for Regions and independent regulators (law 106/2011).

Except for in a few exceptional national and European cases, measurement is based on the following steps.

The “mapping” activity must identify the information obligation (IO), which could be, for instance, applications for authorization or subsidies, notification of activities, cooperating with audits/inspections, statutory labelling for the sake of third

parties, or providing statutory information for third parties [SCM Networks, *International Standard Cost Model Manual*, 2005]. This activity consists in the identification of the rules, inside the regulations concerned, which impose an information obligation and its classification by origin (international, European, national, regional or local level). Then the required actions to fulfil the IO must be identified (such as familiarization with the IO; collection of relevant data; internal/external meetings; storage of the information obligation with a view to subsequent production in connection with an inspection; reporting/submitting information to the relevant authority) [SCM Networks, *International Standard Cost Model Manual*]. The analysis of relevant regulation may also help to identify the frequency of required actions (for instance, if the registration has to be produced and sent every four months, the annual frequency is three).

Then, the analysis must assess the performance of a “normally efficient entity”, which means the time (and the subsequent cost) needed by a “normally efficient business” in order to carry out all the administrative activities associated with the considered IOs. In fact, according to International SCM Manual, the goal is for the businesses to handle their administrative tasks “neither better nor worse than may be reasonably expected”. This relevant data could be gathered by telephone and face-to-face interviews, consultation with experts, use of existing data or a mix of these techniques (as suggested by the international experience).

The estimation of the total administrative burden is performed through a basic formula for calculating administrative burden for each IO:  $\text{Price} = \text{Tariff} \times \text{Time}$ .  $Q = \text{Number of business} \times \text{Frequency}$ .  $\text{Tot P} \times Q$ .

According to this basic formula (adopted by all the countries engaged in administrative cost measurement) the price represents the cost which the firms incur in performing the administrative activities. Specifically, it represents the hourly rate of the person who deals with the IO (internal cost), which corresponds to the wage costs plus overheads for administrative activities done internally (such as expenses for premises, telephone, electricity, IT equipment). When external advisors deal with outsourced tasks for the businesses (external costs), the cost corresponds to the hourly cost for external service providers.

These hourly prices must be multiplied by the time required to carry out the administrative activity, measured in hours. Then, the number of regulates affected must be multiplied by the frequency within which each administrative activity must be completed each year.

As a tool it targets *ex post* simplification and is a specific impact that must be analysed in *ex ante* impact assessments (as in EU and in Italy).

The weak points of the SCM are directly linked to its limited scope and the pragmatic methodological approach of the analysis.

It is an incomplete instrument, because it ignores other categories of compliance costs and the benefit of the regulation measured (therefore, the subsequent simplification activity should take into account the risk of reducing public guarantees). Moreover, SCM (as well as IA) does not identify the cumulative impact of regulation. Indeed, the method is based on some assumptions: a representative sample is used to collect information about all businesses involved in the IO, data are collected on a selected normally efficient business, and it assumes the full compliance to regulation. Further, the method only produces partial information when regulations come from different levels of government (as is the normal situation in Italy). Finally, the stakeholders may not receive real benefits from the reforms when administrative obligations are accomplished through intermediaries and employer organizations (as is often the case): they will gain from the reduction of administrative burdens without necessarily reversing those gains to end users.

These considerations do not override the objective advantages of the SCM method, principally connected to its flexibility and simple application, which consequently generate limited procedural costs. It can therefore be used to measure the whole of the existing regulation (as has already been implemented in some countries) and allows for international comparison and benchmarking. Moreover, there is no doubt that the reason for its widespread use is its ability to deliver results (in terms of money saved) which policy makers can easily communicate to the public.

The above mentioned limits might and have already stimulated evolution and variants of the traditional method. For instance, Denmark is experimenting with an SCM application



which does not start from existing rules, but from an end user investigation of real needs and expectations regarding simplification [MindLab, *The Burden-Hunter Technique. A User-centric Approach to Cutting Red Tape*, Beskæftigelses Ministeriet, Skatteministeriet, Økonomi- og Erhvervsministeriet, Copenhagen, 2008]. The current Dutch measurement concerns administrative costs and the compliance cost of regulation. France simultaneously analyses costs of information obligation, the costs of “administrative delays” (i.e. expenses and loss of income generated while companies must wait for the mandatory decision by the competent administration, and the internal costs to the regulators from managing each rule. Another variant could lead to the monitoring of the flow of information coming from the regulated to regulators, in a way that permits detection of effective compliance including over-compliance due to error (as tested, for instance, in the Italian region of Lombardy and in some Italian governmental administrative burden measurement to integrate data obtained through the traditional SCM). At European level the “traditional” approach (based on the evaluation of individual initiatives through a single tools) is to be completed by a so called fitness check of policy sectors, which is intended to identify “excessive burdens, overlaps, gaps, inconsistencies and/or obsolete measures” and, doing so, the cumulative impact of legislation (Commission Work Programme 2010: *Time to act*, COM(2010)135; pilot exercises started in 2010 in four areas: environment, transport, employment and social policy, and industrial policy).

### **7. Impact assessment analysis**

Impact assessment analysis is a systematic and comparative appraisal of how proposed rules will affect stakeholders, regulators, economic sectors, the environment, and the public administration (for instance, other departments) or regional and local governments.

Essentially, IA is a process which moves from the general strategy underlying the logic of intervention (the definition of the problem), to the identification of relevant options, and finally to the in-depth analysis of options that are not only “relevant” in the sense that they can achieve specific objectives, but also feasible.

The US was a pioneer in the 1970s, when several executive orders introduced a “regulatory impact analysis programme” (i.e. a “programme that uses systematic analyses of the economic effects, often including benefits and costs, that are expected to result from proposed regulations for the purpose of informing policy makers”). The term economists use for such analyses in their more developed form and that is also used for project and programme evaluation is “Cost-Benefit analysis” [J.F. Morral III, *An assessment of the US regulatory impact analysis program*, in OECD, *Regulatory impact analysis. Best practices in OECD Countries*, 1997, p. 71 ss.]. In this context, the use of economic analysis for major rules adopted by federal executive agencies found fertile ground: the evaluation of federal projects dates to the 1930s (when the Flood Control Act stipulated that the economic benefits of federal flood control projects had to exceed the costs) and the impact analysis could be considered as complementary to the reason-giving requirement of the Administrative Procedure Act. Regulatory impact analysis is limited to the executive agencies under Presidential control, and the IA watchdog is an executive office of the President (the Office of Management and Budget). Therefore, the Regulatory Impact Analysis is not mandatory for Congress and only in 2011 have independent regulatory agencies been invited to consider the costs and benefits of regulations “to the extent permitted by law” (E.O. 13579 of July 2011). Due to the emphasis on Cost-Benefit Analysis, Impact Assessment has been mostly efficiency-oriented; even if special attention to equity is now emerging, as well as to distributional impact and other advantages in such areas as the environment, or public health and safety [see E.O. January 18, 2011, *Improving Regulation and Regulatory Review*]. Moreover, on January 30, 2009 the presidential memorandum on *Regulatory Review*, asked the Director of the OMB to address the role of three factors which are not always fully included in cost-benefit analysis: the interests of future generations; distributional considerations; and fairness. In the UK, the *Impact Assessment* (adopted in 1998 as an evolution of the previous Cost Compliance Assessment) concerns all governmental and parliamentary regulation and assesses the impacts on business, the third sector and society through different economic analysis instruments.

At European level, the business impact assessment system (1986) evolved into the current impact assessment method (2002), which concerns binding and non-binding proposals [C. O'Connor Close and D.J. Mancini, *Comparison of US and European Commission guidelines on Regulatory Impact Assessment/Analysis*, in *Industrial Policy and Economic Reforms Papers*, n. 3, 2007]. The E.C. 2009 Guidelines mandate the assessment of economic, social and environmental impacts (through the CBA, cost effectiveness or multicriteria analysis), and imposes specific analysis to evaluate the impact on competition and administrative burdens. Although general exceptions have not been made, the concept of "proportionate level of analysis" for any IA has been conceived. It relates to the appropriate level of detail of analysis which is necessary for the different steps of IA, and is connected to potential impact, political significance and the steps in the process of policy development [European Commission, *Impact Assessment Guidelines*, SEC(2009) 92, 12].

In Italy, after ten years of experimentation (starting in 1999), Impact Assessment is now binding for governmental regulation (2008), although it is mostly done in a ritual and formalistic way, as an *ex post* justification of previously adopted decisions. These disappointing results are supported by two procedural choices which frustrate the method. On one hand, IA must be used for all less relevant governmental regulation though, paradoxically, major rules could be exempt. On the other hand, the comparison between feasible options is not based on empirical evidence resulting from economic analysis which is only binding for one proposal (the so-called preferred option). Moreover, the supervisor of IAs (a department of the Presidency of the Council of Ministers) has never (until now) stopped the rulemaking procedure by denying inclusion in the agenda of the Council of Ministers [as is permitted by governmental regulation n. 170/2008]. In 2003, a mandatory IA was imposed on independent authorities (such as the Authority for electricity and gas, the Electronic Communications Authority, the Bank of Italy, the stock exchange supervisor - Consob) which after years of quasi-generalized indifference, have now discovered the usefulness of this tool. It is to be hoped that Parliament itself will fulfil its role as supervisor of these IAs.

Through the various transplants and transfer processes, IA has mutated. However, IA is based on the following fundamental steps:

The definition of the *problem* (for example: numerous eye diseases affecting workers using PCs more than a certain number of hours a day), which will become the logic of intervention is the most important determinant of the quality of IA.

Another fundamental step is the *identification of the objectives underlying the policy options* (for example, the mentioned diseases must diminish at a certain rate), which must be designed by drawing on the SMART template. Therefore, the given objectives must be: specific (precise and concrete enough not to be open to drastically different interpretations); measurable (verifiable in terms of results achieved by the intervention); accepted (by the enforcing authority and by the end users); realistic; time-dependent (it is important to set a time limit).

Then, the baseline (the *do-nothing option*) must be measured, by documenting the overall qualitative-quantitative dimension. In fact, IA is a comparative exercise, starting with the comparison of policy options and the option of not altering the status quo, showing how incremental deviations from the status quo will achieve results. Moreover, this step can keep pressures to not intervene through new regulation when it is not clear what is wrong with the current situation or what its specific undesirable effects are.

The alternative options to the status quo must be formulated, while aiming to select those which are both feasible and consistent. They might be the more intrusive options (such as command and control regulations) or ones more respectful of markets (deregulation, through a complete or partial elimination of the regulation in force in a sector) and individual choice (self-regulation by bodies to whom governments have delegated regulatory powers; education and training campaigns; information; economic and market-based instruments). Such alternative options might include administrative simplification (such as: one-stop shops; streamlining or reducing the necessary steps of administrative procedures; the “silence is consent” rule; the replacement of authorizations with simple notifications of the commencement of the activity; a larger use of IT tools).

The *feasible options must then be measured*, by documenting the overall qualitative-quantitative dimension through one or more of the major techniques of economic analysis: the cost-benefit analysis; the multi-criteria; the cost-effectiveness analysis; the compliance cost assessment; the risk analysis.

The impact of feasible options must be compared in order to *identify* (if possible) a “*preferred*” option because the benefits outweigh the disadvantages.

Then, the project of regulation could always *organize the monitoring and* (if necessary) *the ex post evaluation activities*, aimed at providing information implementation and effectiveness of the rules.

IA has some weak points, which can be summarized as follows. Experts can influence policy makers through a distorted use of technical instruments (like consultation and cost-benefit analysis) [A. La Spina and G. Majone, *Lo Stato regolatore*, Il Mulino, 2000, 102]. The benefits of regulation (which cannot always be monetized or which emerge over a longer term than cost) might end up being underestimated [D.A. Faber, *Rethinking the Role of Cost-benefit Analysis*, «The University of Chicago Law Review», vol. 76, n. 3, 2009, 1362 ss.]. When based on CBA, it assumes that human behaviour is rational, which does not always correspond to how people really behave (see par. 9). Moreover, IA detects the consequences of a single regulation but has a limited capacity to evaluate the interdependence of very different regulatory strategies and institutions [R. Baldwin, *Better Regulation: Tension aboard the Enterprise*, S. Weatherill (ed.) *Better Regulation*, Hart Publishing, 2007, 34-35]. However, these aspects will not necessarily impede the usefulness of this tool: benefits can be assessed by a qualitative analysis, which must always complete the quantification; real people could be assessed through the empirical evidence of behavioural law and economics studies (and by consultation), and agenda setting might help to coordinate efforts and prevent cumulative burdens.

On the other hand, IA presents important advantages. In fact, it allows for evidence-based decisions and detects in advance all the intended and unintended consequences of rules. It provides information on how public choice was made and why, imposes a justification of rules and doing so ultimately generates a form of internal accountability (of the IA analyst to the final decision-

maker), and of external accountability (decision-maker to the IA supervisor, judges, and the end-users of regulation).

### **8. The recognition of good quality regulation as an autonomous public interest and its consequences**

Good quality regulation tools are functional and crucial to attaining the sectorial interests met by regulations: an obscurely and ambiguously written rule is not implemented, a rule which is impossible to implement (because of economic, social, cultural, organizational conditions are mess) is no more than a slogan; a rule which has unintended consequences could create bigger risks than those it was intended to address, and so on. This analysis leads us to consider a «well written» regulation, accountable for its positive and negative impacts on society to be «a value in itself», whatever its political content [APEC-OECD, *First workshop of the APEC OECD co-operative initiative on regulatory reform*, 19–20 September 2001, Beijing, China, 15]. The recognition of the importance of better regulation policies and the diffusion of good regulation tools across countries (even if they partially differ in implementation and in real benefit gained by end users) seem to confirm that many countries recognise the quality of regulation as a public interest autonomous from sectorial interests met by regulations. This new public interest (together with other components) allows for specific public interests to be met.

The recognition of an autonomous interest in good quality regulation has many concrete consequences.

Both aspects of good quality regulation (the formal and the substantive ones) *require the use of specific tools*, which inform the decision maker about empirical evidence regarding the impact of rules and which increase the plain language of rules. Therefore, it is important for economic analysis to be used only for those regulations with the largest potential impact; although it is difficult to find objective criteria to identify them (e.g. US federal agencies must use Regulatory Impact Analysis for projects which may have an annual effect on the economy of one hundred million dollars or more). Moreover, a specific assessment of the risk which a proposed regulation is intended to manage is a useful technical application of the principle of proportionality, and is required in countries with more advanced experience in economic analysis.

Because the recognition of an autonomous interest in good quality regulation requires the use of specific tools it *increases the participation in the decision process* and can subsequently change the relationship between regulators and the regulated even in civil law countries, where the stakeholders' participation is frequently rare and informal. In fact, the above-mentioned tools of good regulation based on economic analysis are based on consultations. However, the many challenges of consultation with interested parties (reduction of asymmetric information; enrichment of the empirical basis for decision-making; increasing opportunities for citizen participation and democratization of the input provided by experts; reduction of the risk of unintended consequences) demand the respecting of some minimum standards. At European level, institutions must respect the general principles set out by the European Commission [communication *Towards a reinforced culture of consultation and dialogue*, COM(2002)704]: participation, openness, accountability, effectiveness, coherence. These principles are translated into specific rules (which are at this time under review), such as a reasonable time limit for participation (at least 8 weeks for reception of responses to written public consultations and 20 working days notice for meetings), adequate publicity about the starting process and all the relevant elements. In the US, where participation in rulemaking dates back to 1946, the 2011 OMB's *Open Government Directive* requires federal agencies to describe how they will improve transparency and integrate public participation into its activities (one application is the "new OIRA dashboard", a website which allows visitors to find and sort rules by a large number of agencies, by length of review, by stage of rulemaking, and by economic significance).

The recognition of an autonomous interest in good quality regulation has an impact on public sector organisation too. In fact, the use of economic analysis in the regulatory process requires a *multidisciplinary approach to regulation*, where lawyers do not have a monopoly on regulations and are complemented by economists, social scientists, statisticians, experts on economic analysis of law, and possibly psychologists. Moreover, the use of economic analysis in the regulatory process needs adequate institutional design, which includes a *supervision step*, such as external bodies like independent watchdogs (oversight) to check the quality of the analysis done in the framework of IA (e.g. the OIRA in the US or

the Better Regulation Executive in the UK), of SCM (the ACTAL-*Adviescollege Toetsing Administratieve Lasten* in the Netherlands and the *NRCC-Normenkontrollrat* in Germany), or the collection of information by American federal agencies (the OIRA in the US). Indeed, it is important to coordinate efforts across different regulators acting at European and national level (governmental, independent, at central, regional as well as local level).

Moreover, the autonomous interest in good quality imposes (or increases) the *duty to justify regulations*. Indeed, the decision-maker has the duty to give reasons for the need for a new regulation and on the specific rule chosen to meet these necessities. When a specific tool to improve good regulation is used, they must also enrich the justification of regulation through the empirical results of measurement. However, it is important to stress that economic analysis does not impose any final choice on regulators. In fact, IA (as well as SCM) prepares evidence for political decision-makers and must be considered an “aid to political decision-making, not a substitute for it” [European Commission, *Impact Assessment Guidelines*, 2009, 4]. As a consequence, the decision-maker could adopt a rule where benefits do not outweigh disadvantages (if, for instance, they intend to eliminate a discrepancy between the fundamental goal of the state and the existing regulation), but this choice must be justified.

### **9. Conditions to improve the efficacy of good regulation tools**

The above-mentioned participation in decision-making, a multidisciplinary approach and adequate institutional design are some of the main conditions to improve the efficacy of good regulation tools.

The principle of *proportionality* in the use of the tools to improve good quality regulation must help to avoid “ossification” of the rulemaking procedure as a consequence of a too frequent use of economic analysis in all regulatory processes (consider that impact assessment typically lasts several weeks, between eight and twelve). At the same time the depth of the economic analysis (as well as the consultation process) must be proportional to the issues at stake and the resources available. For instance, IA may



cover administrative burdens only, or more complex types of costs and benefits, including environmental benefits or distributional effects. In summary, the efficacy of these tools depends even on its selective use. Only major rules might be concerned: if all the flow and the stock of regulation are assessed, the analysis risks being superficial and its costs unjustified.

The efficacy of good regulation tools should also be reinforced by a *regulatory reform agenda* providing at least the principal area or problems to be addressed over one or more years. In practice, tools based on economic analysis (such as Impact assessment and the SCM) are especially time consuming and costly. Regulators should be able to coordinate the necessary resources and to assure the consistency of reform efforts (for instance, to avoid multiple interventions on a single topic in a short period of time). Further, the use of good regulation tools calls for coordination between the time-pressures of politicians (who usually want an immediate answer to problems) and the time needed by experts to carry out economic analysis of regulations. To these ends agenda setting is crucial. A regulatory reform agenda could also help to coordinate simplifications adopted by regulators acting at the same or different levels of government.

Moreover, the search for good regulation is a continuous process (*life cycle of regulation*). It is important to prevent the gains of simplification from being reversed by new unjustified rules or formalities and to check that rules are still adequate to the economic context and to citizens' needs. At the same time, only an *ex post* evaluation can determine how a rule affects society (the real impact of a rule). Therefore, the implementation of the life-cycle management of regulation imposes the use of tools for good quality regulation through the life of regulations to avoid outdated and unneeded rules which impede competitiveness, consumer welfare and increase regulatory uncertainty ("a review and adjustment process", as emphasized by R. Baldwin, *Better Regulation: Tension aboard the Enterprise*, p. 45].

Finally, data related to human behaviour has to be handled sensitively: the assumption that human behaviour is rational (which informs cost-benefit analysis and the SCM) seems contradictory to the observations of everyday life. In fact, on one hand human persons' choices are influenced "by culture views,

and ethical ideas about the good” [P. Koslowski, *Principles of Ethical Economy*, Kluwer Academic Publishers, 2001, 244]. On the other hand, behavioural economics (based on evidence provided by psychological and neuroscientific studies) suggests an approach to regulation which considers a series of elements which could be more relevant than rational human choices [OMB, *Report on the Benefit and Costs of Federal Regulation*, 2009]. Specifically, people often use heuristics (or mental short-cuts) to assess risks, and probability is mostly neglected; for example, predictions about actions tend to be optimistic or pessimistic according to positive or negative market indexes over a given period of time. Moreover, inertia has a large effect on behaviour and people often procrastinate or decline to make the effort to rethink decisions (“how many households are aware that there may well be ways to save energy – and plan to investigate those plans tomorrow?”). Finally, information that is vivid and salient has a far larger impact on behaviour than detailed information (the presence of an “ambient orb,” which glows red when energy use is high, produces larger decreases in energy use than early attempts to notify people of their energy use by text messages) [these two examples are given by C.R. Sunstein, *Humanizing Cost-Benefit Analysis*, *Administrative Law Review* Conference, February 17, 2010; see also R.H. Thaler and C.R. Sunstein *Nudge. Improving Decisions about Health, Wealth, and Happiness*, Yale University Press, 2008]. An understanding of these findings has numerous implications for regulators. “Rather than educating people out of error, a more effective approach may be to take the biases into account when designing policy” [D. De Meza, B. Irlenbusch and D. Reyners, *Financial Capability: A Behavioural Economics Perspective*, «Consumer Research», 2008]. For instance, disclosures should show consumers the consequences of their financial decisions instead of increasing information about financial products (as suggested by the U.S. Treasury Department to the Consumer Financial Product Agency). Moreover, the simplification of choices through default rules (which specifies the outcome in a given situation if people make no choice at all and is a typical example of “nudging”) could be particularly useful if the logic of intervention is to increase enrolment in a retirement plan, because inertia usually affects our choices [OIRA, guidance on *Disclosure and Simplification as Regulatory Tools*, 2010]. A *behaviourally informed*

*approach* to regulation in the IA could help to design policy options which consider the incentive to be created for real people and assess compliance considering the possibly irrational reactions of end-users.

## 10. Conclusions

Over and under-evaluation of good regulation tools is dangerous. Both approaches could be used as a justification for reforms made in name only or for partial reforms.

On one hand, over-evaluation can lead to a use of these tools as the sole answer to bad regulation and consequently overlooks the structural problems which give rise to regulatory inflation. On the other hand, under-evaluation might justify a formalistic approach, such as a box-ticking routine.

In fact, it is crucial to understand what good regulation tools are really intended for.

Impact assessment gives evidence about impacts which are only presumed. This is due to the timing of when it is used (and not only to the correct consideration about unpredictability due to the fallacy of human behaviour). Specifically, CBA is a pure economic instrument, which was not conceived to reduce difficult questions to problems of arithmetic [C.R. Sunstein, *Humanizing Cost-Benefit Analysis*], nor to solve equity or distributional problems, nor to judge controversial political or moral values which “will necessarily be made through ordinary administrative and democratic processes” [R.H. Pilades e C.R. Sunstein, *Reinventing the Regulatory State*, in «University of Chicago Law Review», vol. 62, 1995, n. 1, 62 e 65]. Therefore, Impact Assessment does not substitute political decision-making, but prepares evidence for political decision-makers about the potential impacts of possible policy options, opens procedural decision making to participation and requires decision-makers to give reasons for their final choice (not only as regards the facts and the law which supports the decision, but even regarding data resulting from the analysis and the consultation process). As a result, both the rulemaking procedure and the eventually adopted regulation are modified.

The SCM is intended to quantify administrative formalities in order to make clear to rule-makers which specific parts of the

regulations are especially burdensome for different end users (due to unnecessary information obligations) in order to streamline the way in which public interest is implemented. In other words, the method neither aims to change policy objectives set out in the existing regulation nor the level of ambition in existing legislative texts. As stressed by the European Commission, it is clear that the information obligations simplification “should not compromise the underlying purpose of the legislation and there are clearly cases where, *inter alia*, for reasons to do with the protection of public health, protection of workers’ rights or the environment or the need to protect the Community’s financial interests and ensuring sound financial management, information obligations will remain necessary” [*Action Programme for Reducing Administrative Burdens in the European Union*, COM(2007) 23 final]. Even in these cases politicians have the last word in the decision to reform regulation. However, the quantification of information obligation (and, if necessary, of other costs such as the “costs of delays”) forces regulators to consider costs of regulation which they tend not to consider or even know, involve the end-users in rule-making and reduce administrative burdens of necessary regulations.

Further, good regulation tools are not intended to determine the cumulative burden imposed by different regulations and the cumulative impact of different regulation projects. Not even information written in plain language can ensure that real people receive the right incentives (as demonstrated by behavioural economists).

The functionality of good regulation tools is limited to improving residuality, proportionality, consistency and accessibility of regulation. However, even to achieve these basic objectives they have to be used in a proportionate way, and they must be backed by adequate organizational design and by strong political support.

Moreover, the use of good regulation tools can start a virtuous cycle. They certainly increase transparency in decision-making, reaffirm the duty to give reasons, and improve participated processes. At the same time, their limits could incentivize the search for innovative solutions, such as a special attention on the needs and behaviour of real people, in the design of new regulation and in its measurement and reform. For

instance, Impact Assessment could consider cognitive biases and heuristics as risks whose probability may be analyzed in order to give an indication about the possible opportunity to deal with presumed cognitive errors through regulation, which puts into practice the principle of proportionality. The Standard Cost Model could evolve in its use for regulatory reform to ensure that simplification or de-regulation really benefits consumers. To this end an effort to communicate reforms could be useful (if it becomes easier to comply with an information obligation, then a part of end-users could decide to comply and not ask for help from intermediaries). Another way could be an effective competition between intermediaries, which could involve competition on prices and on the quality of services, which also means not offering clients unnecessary services.

Finally, good regulation tools impose an approach to regulation as a cycle, where residuality, proportionality, consistency and accessibility must be reanalysed periodically and must also be used in the framework of a comprehensive approach to regulatory reform, which addresses regulation sectors through good regulation policies, instead of single regulations through a single good regulation tool.

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