

Tough competition: why cutting regulation is so hard for the EU

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*In the third of his posts covering the UK's renegotiation strategies, **Frank Vibert** argues that David Cameron is pushing at an open door in wanting a more internationally competitive European Union. But though the EU might be able to reach agreement on its goals in this area, institutional tendencies to over-regulate – and business demands for legal certainty in a large market – mean that change will still be difficult to realise.*



When the Governor of the Bank of England, Mark Carney, [intervened](#) in the debate about British membership in the EU, he stressed the dynamic benefits conferred by the single market on the British economy. Unfortunately, although the single market is a very large one, it is not dynamic. Other markets outside the EU – such as the US, India and China -have been growing much faster. Even with the slowdown in world trade, and in China more specifically, non-EU markets offer more dynamic growth prospects.

It is the need to revive the dynamism of the single market that the British government is trying to address by identifying 'competitiveness' as one of its four key negotiating aims. Competitiveness differs from the other three British negotiating aims, in the sense that in this case the UK is pushing at an open door rather than having to overcome a general reluctance or resistance. All the member states are concerned about Europe's poor economic prospects, its high unemployment levels and particularly serious youth unemployment levels.

In his now famous [letter](#) to EU president Donald Tusk, Cameron's proposals on competitiveness included a number of references to specific policies in the single market, including the need to bring capital markets closer together. 'Capital markets union' plays to the hope that businesses in the EU can turn more to equity financing to meet their needs and become less dependent on bank financing. The pattern of corporate funding in the EU would thus become more similar to that in the USA. Start-up companies would be among the intended beneficiaries of such a shift.

Regulatory techniques and drivers

The main thrust of the PM's letter is, however, about the costs of doing business in the EU. Here the UK government's key target for change is the need to lower regulatory burdens. This means finding ways to reduce the existing stock of regulation and to minimise new regulatory burdens arising from fresh EU legislation.

Over the past 20-25 years, the European Commission has embedded in its working practices all the techniques of regulatory scrutiny that are to be found in developed markets worldwide. Cost/ benefit analysis, tests of necessity and proportionality, mechanisms for regulatory oversight and evaluation are all to be found in Commission practices. It has introduced the usual mantras of 'better regulation' or 'smart' regulation into its lexicon and has carried out various exercises to simplify and to reduce the size of the existing rule book for doing business in the EU. No doubt technical improvements are still possible. But the core of the problem is not about the techniques of regulatory practice. It is about the underlying drivers behind the urge to legislate and to regulate.

If the British government is to return from the negotiating table with a convincing story to tell Conservative and Ukip voters – at least on reducing the costs of doing business in the EU – it has to offer more than Commission promises on how to carry out 'better regulation'. Cameron and George Osborne have to be able to say how they have blunted the underlying drivers behind the EU's compulsion to regulate. There are two different types of driver. One centres on the institutional incentives to regulate. The other involves the quest for legal certainty in the single

market, popularised in such expressions as the need for ‘a level playing field’ and a uniform compliance that avoids ‘gold plating’ at one end, and avoidance at the other.

Institutional incentives

What lies behind the EU’s urge to regulate? Public choice theorists focus their attention on the institutional incentives involved, especially as they relate to the jewel in the crown of the European Commission’s powers – which is its right of initiative in all legislation. Take this away and the Commission becomes like any other bureaucracy. Meanwhile, the jewel in the European Parliament’s crown is its right of co-decision on new legislation, shared with the Council of Ministers. Take this away, and the Parliament becomes a mere talking shop.

Put in another way, according to a public choice view, the *raison d’être* of the 28 members of the European Commission (and their staffs) is to come up with new proposals for EU action. The *raison d’être* of the integrationist majority in the EP is to co-legislate new measures. Neither have any self-interest in legislative or regulatory restraint. Nor do they have a particular interest in spending time and attention on ways to reduce the stock of existing regulation.

If this view of institutional incentives is correct, it will not be possible for British negotiators to address the problem head-on, even if they wanted to. At best it might be possible to negotiate an Inter-Institutional Agreement that all future measures that add to the costs of doing business in the EU should come with ‘sunset’ clauses attached – so that they will expire automatically.

The more radical alternative, from a public choice perspective, is to bypass the Brussels incentive system and to turn to national parliaments to keep regulations in check. For example, a largish minority of national parliaments might be able to propose deletions to the existing rule book, and also be able to block new measures that would increase the costs of doing business. Possibly actions to propose deletions could be agreed by the European Council on the basis of a simple majority of member states. The PM’s letter refers to a ‘red card’ role for national parliaments in the context of ‘sovereignty’. Such a red card system might also have an application in relation to the costs of doing business.



Volkswagen vehicle emissions ... a failure of EU law and regulation to assure certainty in the single market. Photo: [Markus Schoepke](#) under a [Flickr Creative Commons licence](#).

Honesty and legal certainty

The quest for legal certainty is not about public choice. It is about private choice, and in particular about the desires of private business. The business attitude towards regulation is two faced. Businesses deplore it – but they are often supporters of it.

Economists often fail to point out that markets do not work unless there is honesty and an absence of intent to defraud in contracts and pricing – the twin pillars of any market system.

We can decide on the honesty of a trader in a market with repeated face-to-face contact. In any large market that involves distant relationships, such as the EU's single market, we rely on the law to uphold contracts and to punish dishonesty. Adam Smith referred to 'emotional distance' as the reason for law.

In the case of the single market, EU law provides an attractive way of introducing legal certainty into commercial and business relationships. Otherwise businesses have to make their own judgments on the possibilities and timeliness of redress under, for example, Bulgarian or Italian law. Despite well-noted differences in what is euphemistically called 'compliance culture' (due to non-enforcement in some locations) the demand by businesses for a level playing field is a frequently recurring refrain.

Unfortunately, in the case of VW emissions standards, it has become all too apparent that EU law and regulation does not assure honesty in the single market. The British government could therefore use the opportunity to open up a different kind of debate on how to improve standards that does not involve ever-increasing recourse to EU law.

The alternative to ever-greater reliance on EU law involves efforts by national authorities on two fronts. Emphasising the importance of business ethics is a first strategy. A second might be bringing civil and criminal prosecutions against those who transgress. It is unfortunate for Cameron and Osborne that the UK's own record is poor on both these counts. It has never been clear what ethical standards are included under the 'fit and proper persons' test applied to company boardroom appointments by the Business and Innovation department on behalf of the UK government. Equally, as the cases of Northern Rock, HBOS and RBS in the 2008 financial crisis all demonstrate, there has also been a great reluctance by UK authorities to prosecute business wrongdoing.

Yet leaving aside the less than stellar performance of the British government, it might be possible for the member states in the European Council to agree that they will each be more active in promoting codes of ethics and in prosecuting wrongdoing in their own markets. They might start with VW.

The fact that for once the British push on competitiveness faces an open door in terms of other EU states' reactions will be refreshing for the UK government. The difficulty is that it is not clear how far this general receptiveness translates into a willingness to look at the fundamental drivers behind EU regulation – either the institutional drivers, or the quest for legal certainty. The door is open; the cupboard may be bare.

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