

REGULATION AT THE EDGE

Regulation for resilience – a regulatory revolution for sustainability



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How can we create a truly sustainable economy? We believe one essential way is to create a radically new regulatory paradigm for the 21st century. Traditional 20th century regulation has had its day, and a revolution is needed. The goal posts have moved, and we need to reinvent our regulatory systems accordingly. In the 21st century, societies will need to regulate for resilience.

Saying goodbye to an old friend

There often comes a time when we need to leave behind something which has served us well, but is no longer fit for purpose. This is now true of traditional regulation. It is an old friend which has contributed to prosperity in the 20th century, but is now holding us back from achieving our true potential.

Who is this old friend we call 'traditional regulation'? A defining characteristic is that traditional regulatory measures address a single issue or small sub-set of policy problems. For example, UK clean air regulation was set up after the great smog incidents of the 1950s, and represents a prime illustration of the powerful success delivered by traditional regulation. A specific problem – air pollution – was directly addressed, and industrial companies took a set of specific actions to reduce their pollution levels and comply with the regulations.

Traditional regulation still delivers outcomes important for our quality of life and the effective functioning of our economy, but at increasingly higher cost for the value derived. This is why we need to wish it farewell.

We need a regulatory revolution because the nature of the challenges societies must confront in the 21st century is fundamentally different from those of the 20th century.

The major challenges of the 21st century are systemic in nature. They will throw into question the resilience of our systems. Very few, if any, regulations are systemic in scope. We need to build upon the success delivered by traditional regulation and use this to inspire the creation of a new regulatory approach which tackles 21st century challenges.

The 21st century: an era of systemic challenges

From a sustainability perspective, what do we mean by systemic challenges? Let's highlight the examples of challenges to our environmental, economic and social systems.

The planet's environmental system is facing unprecedented pressures from population growth, climate change and ecosystem service depletion – not to mention its own ability to throw up surprises. The Stockholm Environmental Institute (SEI) highlights this four-way squeeze and has identified nine planetary boundaries which, through human development, we are pushing up against.

These include the limits to the nitrogen and phosphorous cycles, the availability of global fresh water and the loss of biodiversity. The SEI argues that even when just one of these boundaries is crossed, there are knock-on effects which put others in jeopardy. Its latest evidence suggests that we have already crossed several of these boundaries.

The SEI explains that, if we are to stay within these boundaries, a shift in mind-set is needed towards a system of governance that is persistent, adaptive and transformable.

Another example is the systemic challenges to our economy, which receive daily media coverage. We have had recessions before, but the scale and nature of the current problems are evidence of a system under extreme stress.

About three years ago, many OECD nations launched almost unprecedented fiscal stimulus packages to avoid the possibility of a major and prolonged recession. At the same time, some of the largest government buyouts in history were made to save major financial institutions and the financial system itself. Governments argued that these drastic measures would stabilise the economic system.

Yet three years later, most OECD countries are in recession or experiencing low and fragile growth. Sovereign debt crises continue to mount, despite the fact many nations have embarked on austerity packages similar in scale to the stimulus packages of only two or three years ago. The health of our financial system continues to teeter on the edge of, at best, crisis and, at worst, collapse. No matter what governments try, our economic system seems to lack resilience.

Thirdly, understanding the complexities of disruptions within our social systems is particularly challenging. Following the London riots in August 2011, the unrest was put down to everything from bad parenting to gang culture to aggressive consumerism. Several months and investigations later, it is near impossible to pin down just one or two reasons why a localised protest turned into widespread violence and looting.

Similarly, the reasons behind the Occupy protest movement in financial centres around the world seem particularly difficult to get at. A criticism of the protesters is that they often don't seem able to articulate what the problem is and what they think should be done about it. They are angry, they see the current system isn't working, but the complexities are such that there is no silver bullet solution.

The Occupy movement could be considered evidence that the stresses on our environmental and economic systems are spilling over into our social systems, adding to the endogenous tests that they have to withstand and challenging our social resilience. People, including some who have never

protested before, are calling for a different way of doing things – a way that does not lead to crashes, inequality and overconsumption.

Why revolutionise regulation?

So why do these questions of systems resilience demand a regulatory revolution?

Let's consider just one of many potential scenarios. Suppose new evidence emerges that our marine and freshwater systems are under more imminent threat of collapse than previously thought. Do we review our 'environmental budget' and shift resources from climate change initiatives to this 'more pressing' problem?

Suppose also that OECD governments substantially reduce sovereign debt levels, thereby restoring a high degree of resilience to our economic system. But by prioritising fiscal debt reduction, we have done nothing to redress our growing 'ecological debt' levels. What happens if the UK's budget is balanced in 2020, but the nation's ecological footprint has grown, manifesting itself in severe impacts such as more regular extreme flooding across the country?

This scenario is hypothetical, but plausible. We are not arguing that disaster awaits around every 21st century corner. Instead, we are pointing out that, because our major challenges are systemic in nature and potentially large in scale, our regulatory systems need to be revolutionised to ensure that:

1. all regulations are judged by how successfully they contribute to system health and enhanced systems resilience; and
2. the resources of regulators and regulated businesses can be quickly redirected when shocks occur that threaten the resilience of our environmental, social or economic systems.

How will we recognise our new friend?

As we wave goodbye to our old friend, what will our new regulatory friend look like?

Currently, in many OECD jurisdictions, there are certain tests that a Minister must pass to make a new regulation such as:

- the benefits of the regulations must outweigh the costs;
- the net benefit of the regulations must outweigh the net benefit of non-regulatory options; and
- a new regulation can only be introduced if an existing regulation is abolished (the 'one-in-one-out' rule).

In the 21st century, our proposition is that the tests should be dramatically tougher. Any new regulation should:

- improve outcomes in at least two other portfolios (eg environmental regulation can only be passed if it improves outcomes in, say, health and education);
- reduce public expenditure over a 10-year period by enhancing system resilience to reduce expenditure in either existing or future (avoided) government programmes;

- be redundant through its own success within 10 years – regulations will need to solve problems and make our systems self-sufficient, not create publicly-funded regulatory programmes in perpetuity;
- increase, not reduce, the profitability of businesses being regulated; and
- demonstrate how it will remain effective if major shocks to other parts of our environmental, economic and social systems occur (ie how the regulations can be flexible enough to facilitate rapid redeployment of resources).

For responsible businesses, red tape will be slashed and innovation supported. Businesses which abuse this new system and don't meet minimum compliance will be dealt with quickly and harshly.

What can businesses do?

So if you are a businessperson and you like the sound of this regulatory revolution, do you just have to sit tight and wait for government to make it happen?

Not in our view. Now is exactly the right time to push for this revolution. In the UK, the Government is actively seeking ideas for major regulatory reform. You might also be surprised by how many senior regulators want to create transformational change.

Contribute to the policy processes in your country and push for these types of changes. In addition:

- ask the people who regulate you one simple question: "If we put the regulatory rule book to one side, what are the major risk and return factors you manage corporately and personally?" We have found this question opens up new ways of thinking and new scope for negotiation;
- seek to have all your regulatory obligations under various laws combined into a single 'regulatory compact' which has full legal force, allowing you to negotiate priorities and timelines much more easily;
- ask if you can make environmental or social gains at lower cost (or, even better, at positive returns) by instigating actions in your supply chains or product design, rather than in further action at your own sites; and
- offer to have your CEO sign a one-page annual compliance statement certifying your company's compliance performance, as an alternative to sending lots of data to multiple regulators.

You may even find that by taking the initiative and asking these questions, you discover that new friend – **the regulatory revolution that helps unlock the sustainability innovations your markets are calling out for, and that helps restore the resilience of our environmental, economic and social systems.**

Terry will be available on our [CSN LinkedIn Group](#) to hear your views, or, if you would like to get in touch with him to discuss regulatory reform projects he's involved in, please [email us](#).