AUSTERITY and its ALTERNATIVES

Regulatory Austerity's Implementing Tools

Regulatory Capture, Trade Agreements, and Regulatory Budgets

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ABOUT US

Austerity and its Alternatives is an international knowledge mobilization project committed to expanding discussions on alternatives to fiscal consolidation and complimentary policies among policy communities and the public. To learn more about our project, please visit www.altausterity.mcmaster.ca.

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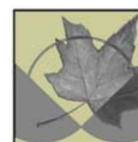

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Introduction

While the disastrous and dangerous policy of fiscal austerity has been central to progressive critiques of neoliberalism, deregulation and its consequences —or what I call regulatory austerity—is not so well known.

The two are linked in the following way. The application of pressure by companies to reduce or eliminate regulations is designed to reduce their compliance costs and let them regulate themselves. Fiscal austerity causes reductions in regulatory resources, which in turn provides the rationale (or necessity) for regulators to shift to greater company self-regulation— a situation where companies are given latitude to make their own calculations and compromises between public safety and profits. It's a vicious cycle of shrinking resources and greater self-regulation.

Neoliberal proponents view regulations almost exclusively as costs to business (red tape), which must be reduced. Deemed analogous to tax cuts, they use the same arguments. Reduction of these "silent job killers," as former Prime Minister Harper called them, will stimulate private investment, job creation and economic growth; and the "rising tide will lift all boats."

The macro-economic evidence of the last three decades points in the opposite direction: slow growth, reduced private sector investment and productivity growth, rising unemployment, widening income and wealth inequality, deepening economic insecurity and poverty. Catastrophically, deregulation of the US financial system triggered a global financial and economic crisis, producing massive job loss, deep recession and ongoing economic stagnation.

Both a cause and consequence of widespread regulatory capture by industry, the shift to company self-regulation has resulted in lower costs to both government and business; but also the loss of government's ability to regulate in the public interest. Regulatory systems have become increasingly dysfunctional: vague rules, lack of inspections to verify compliance, the lack of enforcement tools and penalties to ensure compliance, and the lack of will or ability to enforce company violations.

Only after regulatory breakdown causes a major disaster is the true cost of regulatory austerity and the myth of corporate self-regulation (an oxymoron to be sure) exposed. Only then does the public become aware of the deep flaws in in regulatory regimes, and lose confidence in government's ability to protect them. Canadian examples include the Ocean Ranger, Westray Mine, Walkerton, Listeriosis, and most recently, the July 6, 2013 Lac–Mégantic oil train disaster.

My own research over the last three years has focused on the multiple regulatory failures and corporate negligence behind Lac-Mégantic, which killed 47 people, left 27 children orphaned, destroyed the town centre, spilled six million litres

of toxic material into the surrounding the soils and waterways, and traumatized a community.[1]

They included a dysfunctional rail regulatory regime—notably an resourced starved regulator captured by a rail industry that was essentially regulating itself; a government ideologically opposed to regulation which cut the rail safety budget at the very time when oil traffic was spiking exponentially; a government fixated on enabling the oil industry to get their product to tidewater, and which along with industry lobbies, opposed any measures that would impede their agenda. And willful blindness by both to the dangers and deaf to any public official, or other critics, who dared speak out.

In Canada, federal and provincial governments have been swept along by the deregulation wave, beginning in earnest in the 1980s with the Mulroney government, gathering steam with Chretien and Martin governments, and pursued most aggressively by the Harper government. Sub-national governments have followed similar paths.

There have been numerous deregulation initiatives: from the Neilson Commission (mid-1980s), to the Committee on Smart Regulation (2000s), culminating under the Harper Conservative government with the Red Tape Reduction Commission (2010), and the Cabinet Directive on Regulatory Management (CDRM) in 2012, the centerpiece of which was the one-for-one rule to operationalize its regulatory budget.

Throughout this period a plethora of international 'free trade' agreements, advanced and entrenched corporate power at the expense of workers and the fiscal capacity of the social state to fund programs; and further constrained the state's ability to regulate in the public interest. Internal trade deals were also struck to align provinces with the new global reality.

Regulation is not generally at forefront of public consciousness, that is, until there is a major breakdown in the system. Nevertheless, when asked by pollsters, citizens prefer a precautionary, or safety-first, approach to regulation, which is ironically at odds with the deregulatory trend of the last three decades. An Environics poll commissioned by the CCPA found that 76% of citizens surveyed agreed: "governments should impose stricter safety regulations if they have reasonable cause for concern, even if there is no conclusive scientific proof."[2] Furthermore,

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1 I have written three major reports and numerous articles on the Lac-Mégantic disaster, its causes, consequences and the policy response: The Lac-Mégantic Disaster: Where Does the Buck Stop? CCPA, October 2013; Willful Blindness? Regulatory Failures Behind the Lac-Mégantic Disaster, CCPA, August 2014; Lac-Mégantic: Loose Ends and Unanswered Questions, CCPA, Jan. 2015

2 Lee, Marc, Canada's Regulatory Obstacle Course: The Cabinet Directive on Streamlining Regulation and the Public Interest, CCPA, April 2010.

three-quarters believed corporations have too much influence over regulations. This confirms polling a decade earlier commissioned by the External Advisory Committee on Smart Regulation.[3]

Statistics Canada estimated that the federal government spent $3.4 billion on regulatory activities in 1997/98, the last year for which, to my knowledge, data are available. This represents about 3% of federal program expenditures, and roughly 0.4% of GDP.[4]

Since then, total taxes levied by all Canadian governments, declined from 36% to 31% of GDP, which translates into roughly an annual loss of $100 billion of fiscal capacity. Given what is known about cuts to specific regulatory bodies, it is safe to assume, that this reduced fiscal capacity, translated into reduced resources for regulators overall.

For example, in the years leading up to the Lac-Mégantic disaster, the Harper government's austerity initiative cut the Transport Canada's Rail Safety Directorate budget by 19% between 2010–11 and 2013–14. The Transport of Dangerous Goods Directorate's tiny $14 million budget had been frozen since 2010. This at a time when an oil by rail boom was in full swing. The number of tank carloads of crude oil on Canadian tracks rose from 500 carloads in 2009 to 160,000 in 2013: and the ratio of safety inspectors went from one per 14 tank carloads to one per 4500.[5]

The key changes in regulatory policy up to and including under the Harper Conservative government, are summarized as follows:

• Risk management and cost-benefit replace precautionary, or safety-first, principles.

• Competitiveness, efficiency, cost, considerations counterbalance and compromise protection of health, safety and the environment as core principles.

• Voluntary codes increasingly replace regulations where deemed appropriate.

• Burden of proof for justifying new regulations shifts from corporations to regulators. "Sound science' criteria provide opportunity to delay or block regulations.

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3 Pal, Leslie and Judith Maxwell, Assessing the Public Interest in the 21st Century: A Framework. Paper prepared for the External Advisory Committee on Smart Regulation. Ottawa: Canadian Policy Research Networks. January 2004.

4 Cited Lee, Marc and Campbell, Bruce, Putting Canadians At Risk: How the federal government's deregulation agenda threatens health and environmental standards, CCPA, Sept 2006.

5 Campbell op.cit.

• Reduced regulatory resources weaken enforcement capacity and increase implementation delays.

• Centralized screening of regulatory proposals adds new layers and opportunities to delay, dilute or block.

• Self-reinforcing cycle of enhanced corporate power, deepening regulatory capture, depleted regulatory resources, and self-regulation.

• International trade and investment agreement constraints.

• One-for-one rule to implement regulatory budgets.

The Harper government took things to a whole new level. Overtly hostile to regulation, the Harper government launched the Red Tape Reduction Commission (2010) mandated to reduce costs of regulation to business. The Commission's report was the basis for government's 2012 regulatory policy, the Cabinet Directive on Regulatory Management (CDRM), which established the marching orders for regulation across government.[6]

The policy included sunset clauses requiring all regulations to be re-evaluated every five years. It also created a centralized regulatory secretariat at Treasury Board to screen regulations and advise the PMO on regulatory policy, including on select regulatory proposals of potential significance to the government's priorities.

However, its centrepiece was the one-for-one rule, which forces regulatory bodies to offset each new or amended proposed regulation by removing at least one existing regulation.

One-for-One Rule: Regulatory Budgeting

Regulatory budgets and one-for-one regulation reduction take regulatory austerity to a new level. This approach has long been advocated within the conservative policy circles. It was first put forward in the US in the late 1970s under the Reagan administration (the term used there is *pay-go*) but never implemented. A limited version was applied in the UK on a trial basis in 2008, but was discontinued as a result of the financial crisis; and a provincial version was introduced under the BC government of Gordon Campbell. One-for-one was the key implementing mechanism for the Harper government's regulatory budget.

The concept of regulatory budgeting as former Harper advisor Shawn Speer explained, is that regulatory bodies must price the cost of their regulatory measures to business (their off-book "expenditures") the same way as their fiscal measures,

6 http://www.tbs-sct.gc.ca/hgw-cgf/priorities-priorites/rtrap-parfa/guides/cdrm-dcgr-eng.asp

namely taxes imposed on business.[7] The purpose is to bring this "hidden tax" out of the shadows. The Canadian Federation of Independent Business (CFIB) estimates the annual cost to business of complying with federal regulations at $37 billion.[8]

Departments and agencies are allocated a budgetary limit of "regulatory expenditures" beyond which the costs to business of any new regulations must be offset through "savings" to business achieved through cuts to existing regulations.

According to Speer, Stephen Harper personally championed this deregulation initiative during its conception and development. The Prime Minister's ongoing personal involvement sent a powerful message to Cabinet ministers and the federal bureaucracy: resistance would not be tolerated.

Despite vague assurances that health and safety, and environmental regulations would be exempt from the regulatory budget regime, there is no evidence that this was applied in practice. As Speer stated: "A narrow baseline with significant carve-outs for certain types of regulations (for instance, ones related to health and safety), or that exclude non-regulatory "red tape" (such as legislative impositions) undermines the effectiveness of a regulatory budgeting exercise".

To operationalize the one-for-one rule, a metric was devised to measure costs to business of regulation; scorecards were established to quantify progress in reducing these costs. To ensure that bureaucrats did not stonewall the government's intent, an external watchdog committee was struck composed of business representatives and deregulation advocates—yet another example of the extent of corporate power in the regulatory process.

The 2015 Conservative Budget reported that the regulatory budget (though this term itself was not used) "saved Canadian businesses over $22 million in administrative burden, as well as 290,000 hours in time spent dealing with red tape between 2012 and June 2014." And it eliminated a net 19 regulations across government.

What is not part of this regulatory budget calculus is any measure of the benefit provided by these proposed regulations in terms of public health and safety, and environment; nor the potential cost to public safety etc. of eliminating a given existing regulation.[9]

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7 Speer, S., Regulatory Budgeting: Lessons From Canada, R Street Policy Study No. 54, March,2016
8 http://www.cfib-fcei.ca/english/article/6928-regulation-costs-for-canadian-businesses.html
9 I am not aware of specific cost-benefits calculations for Canadian regulations. However in the US, The Office of Management and Budget (OMB) estimates that regulatory benefits exceed regulatory costs by 7 to 1 for significant regulations. The Environmental Protection Agency (EPA) estimates that the regulatory benefit of the Clean Air Act exceeds its costs by a 25-to-1 ratio. Cited in *Regulatory 'Pay Go' Rationing the Public Interest* Centre for Progressive Reform, Alert # 1214, October 2012 (p.2)

Regulatory budgets place an arbitrary ceiling on regulation overall which is then systematically ratcheted down on the basis of reducing cost to business alone. It is hugely problematic, leading potentially to a series of Hobson's choices: proposing one protective regulation may also involve removing another protective regulation, necessitating a judgement of which of the two should be sacrificed as being the least harmful.

Regulatory budgets can potentially endanger public safety by hampering the ability of regulatory bodies to address new threats by forcing them to choose to eliminate regulations to protect against existing threats.

What happens for example when a new agency is created to regulate a health issue, say marijuana production and consumption and is accompanied by a set of new regulations? Will regulations in other agencies have to make room by reducing an equivalent number of regulations? What happens when government wants to consolidate a number of distinct agencies into one? What regulatory protections would not have been in place if regulatory budgets blocked them over the last several decades?

Moreover, regulatory budgets create a whole new layer of regulatory obstacles which compounds the challenge to an under-resourced over stretched regulatory body.

What has been the cost to public safety of three years of regulatory budgets under the Conservative government? Is there a link between regulatory budgets, the ratcheting down of the regulatory protections, and a major disaster like Lac-Mégantic? We certainly have evidence of the traditional more common approach: lobbying of senior bureaucrats, political operatives, and Ministers. Although the initiative was in its early stages at the time of the Lac-Mégantic tragedy, the anti-regulation mindset was deeply entrenched and formalized in the CDRM. We'll likely never know what proposed regulations were scrutinized through the regulatory budget lens—blocked, withdrawn, or delayed from getting to the implementation and enforcement stage.

The Harper government tabled legislation entrenching the one-for-one rule approach to regulatory policy in January 2014. The Red Tape Reduction Act came into force in April 2015 making it the first government anywhere to enact such a rule (Bill C-21).[10] Strikingly, it passed with virtually no parliamentary opposition, reflecting the failure of legislators to understand its threat to health, safety and environmental protections for Canadians.

10 http://laws-lois.justice.gc.ca/eng/acts/R-4.5/

When the legislation was introduced in 2014, Liberal leader Justin Trudeau dismissed the one-for-one rule as a "gimmick" that won't make much of a difference in raising the quality of Canadian regulations; "That smacks more of sound-bite politics than meaningful approaches," he said.[11]

The future of regulatory budgeting and one-for-one is unclear. Under the Liberal government, there was no mention of it in its first budget. On the other hand, the Red Tape Reduction Act has neither been repealed nor amended. Will it be quietly dropped or will it be extended in modified form with carve-outs for health, safety and environment?

An interesting postscript: Over the last year prominent Canadian regulatory budget advocates have been writing and speaking to Republican congressional and conservative think tank audiences about the success of the Harper government's regulatory budget initiative.[12] This initiative will most certainly be pushed aggressively during the current US electoral cycle. Besides having broad Republican support in Congress, it will be lead by President-elect Trump. The third item on Trump's *Action Plan for the first Hundred Days* is: "a requirement that for every new federal regulation, *two* existing regulations must be eliminated…"

Trade Agreements – Constitutionalizing the deregulation agenda

Embedded in Canada's regulatory policy, is a generation of international trade treaties—notably NAFTA, CETA, TPP, and the little-known Trade in International Services Agreement (TISA) currently under negotiation—which entrench in quasi constitutional form the neoliberal deregulation agenda.

Not only do they place ever more constraints on the ability of governments to regulate in the public interest, they effectively foreclose the ability of future governments to re-regulate protections ceded by past governments.

Like NAFTA, the recently signed Canada-EU economic agreement (CETA) asserts that while the parties retain the right to regulate in the public interest, they must do so in conformity with their CETA obligations and commitments, notably the

11 *Conservative bill to tackle red tape for small businesses*, Maria Babbage, Canadian Press, Jan. 29, 2014
12 See for example: Speer op.cit., http://www.rstreet.org/policy-study/regulatory-budgeting-lessons-from-canada/
Jones, L. https://www.mercatus.org/publication/cutting-red-tape-canada-regulatory-reform-model-united-states

investor-state dispute settlement (ISDS) system—special arbitration tribunals, which circumvent domestic court systems.

And this means, according to Osgoode Hall Law School legal expert, Gus van Harten: "…legislatures and governments will face new and potentially massive financial risks when they go ahead with laws or regulations that disadvantage foreign investors. The problem…is that the CETA will make some laws and regulations too risky to pursue by putting an uncertain and potentially huge price tag on them."[13] He continues: "CETA (investor-state) tribunals will have the power to order the EU, a member state, or Canada to pay uncapped amounts of compensation to foreign investors."… deterring health, safety, environmental, financial security, consumer, labour, cultural, or any other measures that foreign investors oppose."

Not only are foreign investors granted rights to challenge all regulatory measures that they deem adversely affect their investments, these treaties also contain "regulatory cooperation:" forums which give exclusive access to business lobbies to push continuously—largely hidden from public or legislative scrutiny— for ever lower common denominator regulations. They allow foreign businesses to be heard early in the regulatory process, enabling them to apply pressure to delay or block the adoption of regulations they oppose.

Regulatory Capture by Industry

The extraordinary increase on the power of corporations to shape and drive the regulatory process to benefit its own private interest at the expense of the public good, whether through domestic legislation and regulatory policy, or through trade agreements, undermines a central function of government: to regulate in the public interest.

Regulatory capture exists where regulation is routinely directed to the benefit of the private interest of the regulated industry at the expense of public interest; where industry is routinely able to shape the regulations governing its operations, block or delay new regulations, and remove or dilute existing regulations deemed to adversely affect costs; where regulators' efforts to implement regulations to protect the public hampered by protracted procedures, cuts to its resources, etc.

Capture is a complex phenomenon with a number of dimensions and a continuum reflecting the relative power balance between regulator and industry.

13 Van Harten, Gus, *The EU-Canada Joint Interpretive Declaration on the CETA* Comments on the Leaked "Final Draft" OSGOODE HALL LAW SCHOOL LEGAL STUDIES RESEARCH PAPER SERIES, *Research Paper No. 6 Volume 13, Issue 2, 2016*

[14]*Cultural* capture involves regulators identifying with the interests and preferred policy outcomes of the regulated industry rather than their obligation to regulate in the public interest, conflating the private interest and public interest, and seeing itself more as partner than independent body.

There is also the *revolving door* dimension of capture. Managers are often recruited from industry and then return to industry after a time in government. This is related *to the asymmetrical information* nature of the relationship, characterized by the regulator's lacking its own independent body of knowledge and expertise. Regulators are often dependent for much of their information on the companies they regulate, creating the risk of an implicit quid pro quo: information in return for favourable treatment.

Regulators committed to the fulfilling public interest, are under resourced and under pressure from their regulation-averse political masters to side with industry, and they become increasingly gun shy in the face of criticism from their superiors and political masters.

I have documented substantial evidence of regulatory capture of the rail industry in the lead-up to the Lac-Mégantic disaster.[15] One notable example involved Transport Canada's granting of permission to one company MMA, a company with a notoriously poor safety record, to operate its massive oil trains with a one-person crew?

Several years earlier, the main lobby group, the Railway Association of Canada (RAC), redrafted the rail operating rules, which enabled companies to implement single-person train operations for freight trains without needing a formal ministerial exemption, accompanied by tough conditions. Transport Canada approved this rule modification, without ensuring an equivalent level of safety, and over the objections of the unions and concern from safety experts.

Subsequently, the RAC lobbied hard on behalf of MMA—the first company to take advantage of the rule change—to enable it to run oil trains with a single operator on its Lac-Mégantic line. Senior Transport Canada officials approved the

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14 There is a large literature on regulatory capture, from the work of Chicago school economist George Stigler concerned with corporate interests stifling competition to progressive scholars concerned with public interest issues: health, safety and the environment. See for example: *Old and New Capture, Sidney Shapiro*
http://www.progressivereform.org/CPRBlog.cfm?idBlog=5A83F335-F096-3346-F6A7DB1523221874
Striking at the Root Problem of Canadian Environmental Law: *Identifying and Escaping Regulatory Capture*, Jason MacLean, Bora Laskin Faculty of Law, Lakehead University Forthcoming (2016) Journal of Environmental Law and Practice.
Preventing Regulatory Capture: Special Interest Influence and How to Limit It edited by Daniel Carpenter and David Moss (2013)
15 Campbell, op. cit.

MMA request despite opposition from within Transport Canada itself, and contrary to the advice of its own commissioned National Research Council study.

Conclusion

The impact of the three-decade neoliberal project, driven by global corporations and investors and their political and think tank accomplices, has been transformational. Its mutually reinforcing policy tools, including fiscal and regulatory austerity, trade and investment agreements, have inflicted untold human suffering and environmental damage. Neither multiple social, economic, or environmental crises, nor industrial catastrophes from Bhopal Lac-Mégantic have so far precipitated a serious challenge to the Project from within. Despite some tinkering at the margins, there has been no fundamental rethinking or reform by power elites. However, cracks in its armour are appearing, and societal forces of rejection, resistance and roadblocks to the Project are growing. Whether a countervailing force will emerge to change the status quo—positive and progressive or something much darker—is a story yet untold.