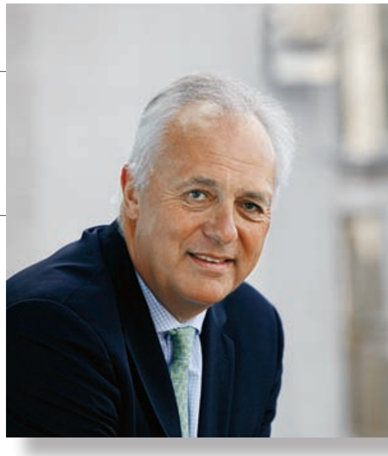
KING REGULATION

National governments' regulatory supremacy is under threat from local and global interests. Between them, they threaten to steal the crown.



MATTHEW STUART FOR *FTI JOURNAL*

MARK MALLOCH-BROWN
Chairman of Europe, Middle East and Africa, FTI Consulting
mark.malloch-brown@fticonsulting.com

A CEO recently observed to me that his father's generation of business leaders had one principal distraction from the core tasks of running a business: labor relations. Today, he continued, the issue that eats an increasing portion of his time and energy is regulation. It's everywhere, governing everything from how employees, customers and shareholders are treated to setting the rules for how businesses are run at home and abroad. Like labor relations, regulation is as old as business itself. But like labor relations in the past, regulation has jumped out of its box and risks consuming the CEO's day, every day.

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And regulation has spawned not only its own industry of advisers and lobbyists, to help comply or change the regulation, it also has shaped the competitive environment of today's business. The modern playing field is not so much tilted as turned into a maze where the winner is not the fastest or the cheapest but the one who knows how to navigate through.

There appear to be three reasons for this plague of regulation. The first is that, as officials have been forced to vacate large areas of their national economies through privatizations, and as private service providers have risen, authorities have not been able to resist leaving land mines behind them. Often viewing the private sector as the enemy, those booby traps are constructed in the name of maintaining the "standards" of service provision.

Such policies also are an expression, though, of the growing irrelevance of national government in many areas of global life. The local matters — building codes or tax arrangements in Shanghai or Buenos Aires; and the global matters — Basel III agreements on banks' capital ratios, or standby arrangements in the case of a breakout of a global communicable disease such as a flu epidemic; but the national often doesn't.

Now, of course, national government is not ready for its funeral rites quite yet: tax rates, personal and corporate; the quality of the macroeconomic environment; or trade and investment liberalization remain critical factors of national competitiveness that are determined by national politicians. Nevertheless, in many areas of economic life the writing is on the wall. The rules are going to be set elsewhere, hence the blizzard of national regulation set off by the self-important snowmakers of national government — officials and their political masters. They want to prove they still matter.

As a former member of a British cabinet, I was rarely presented with a problem that my domestic political colleagues did not want to legislate against. And legislation is of course the tree from which most national regulation falls and takes root. I remember a cabinet divided over whether a colleague's complaint of school bullying was best addressed by a law or by a program of, say, £100 million, suggested by the Prime Minister, or both. I was almost alone in gingerly proposing that the problem was best left to good headmasters and responsible families and that outlawing it was beside the point. But the cabinet wanted to do something, reflecting the politician's most primal need: to be seen to act. That politician's itch is the mother of nearly all national regulation.

There is, however, a second root to the regulatory upsurge: the rise of the global. As we have globalized our economy, fashioning as close to a single market as the world has ever seen, we finally are grappling with regulating that economy. And excuse my bias, for while I consider much national regulation a mountain of red tape that should be set fire to, I am rather a fan of global regulation.

Without regulation, I do not see how we can build a global economy that can enjoy long-term political support. Yet while this mild statement in support of global regulation may seem commonsensical to some, it is to others anathema. Global markets have been seen by some people as a chance to escape national rules, not exchange one yoke for another. These advocates have defended their regulation-"lite" vision by claiming that markets discern the good from the bad, and reward the former. Yet this market fundamentalism, as some have dubbed it, often fails to produce what those involved would consider fair results, for pretty self-evident reasons.

For globalization to work, the markets must be seen as fair, transparent, noncorrupt. Further — and here is the nub of regulation — all players must be seen as subject to the same rules. Global capital, like global health or global security, needs uniform rules of the road.

Another, third reason universal regulation will spread is that countries

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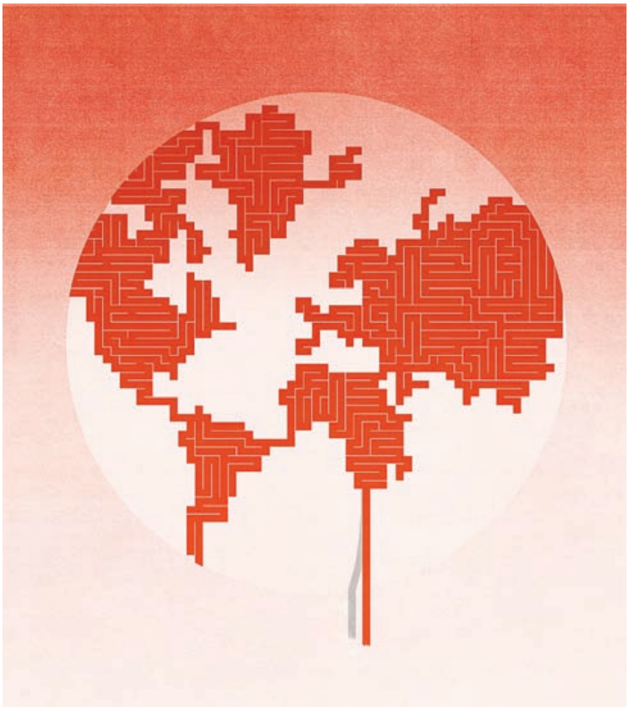

and industries alike will want to end the free rider problem: countries that will not accept environmental standards on emissions, thereby perhaps winning a comparative cost

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advantage; or jurisdictions that go easy on international financial services located in their territories. Finally, as businesses come to operate globally, they will seek common standards that offer predictability.

Such universal regulatory regimes will not deal national authorities out of the process, but instead task them with implementing globally agreed-upon rules and standards at the national level. So Basel III, negotiated as it has been by national officials fulfilling a political framework set in forums such as the G-20, is translated into national regulation by the national financial authorities. The global oak tree that spawns national saplings will not be a global legislative body. Rather, it will consist of international coalitions of interested parties — governments and also industry representatives and often not-for-profit advocates — arriving at common global standards that are likely to be endorsed and adopted by a universal body such as the United Nations. These policies will then be returned to countries for national legislation and regulation to implement the agreed-upon global standards.

So, contrary to what many readers might instinctively believe, global regulation is often broadly a good thing, and a lot of national regulation is basically a bad, redundant thing when it does not conform to global standards.

The difficulty is that governments seem incapable of tearing up the old national rulebook and replacing it with the national version of a global one. Rather, they just pile on the extra regulation, thereby making the maze I described at the start.

Our battle cry needs to be "The old king is dead (national regulation), long live the new king (global regulation, made local)." ■

The views expressed in this article are those of the author and not necessarily those of FTI Consulting, Inc., or its other professionals.