

INTERNATIONAL TRENDS IN (GOVERNMENT) SUPERVISION

FOREWORD

We'll start by saying that we aren't going to tell you anything new, in spite of the fact that we really have done our very best to discover new trends relating to governmental control. This is reassuring, but at the same time, it's also a matter for concern. It's reassuring because the supervision sector is reasonably stable, but it's disturbing because one might think that supervision is trapped in a vicious circle. However, since both these aspects can be qualified in a number of ways, we do have a few items of news for those of you who are still interested.

Where did we get our information from? During the past few months, we've worked our way through piles of paper and read all the relevant literature, and most importantly, we've talked to a great many experts (see Appendix). In fact, we've spoken to everyone who is anyone in the field of supervision and enforcement at home and abroad.

We are not experts. In the space of just a few months, we've drawn up a broad analysis of international trends in supervision, so this analysis has limited depth and scope. We have noted down experts' opinions of governmental control and the trends they have identified in this respect. We should however remark that all trends are accompanied by opposing forces and counterarguments, and we have also mentioned these in connection with the trends wherever possible. Generally speaking, all our discussion partners have endorsed the overview we have drawn up. The aim of this document is to point the way and encourage a debate on the future of governmental control.

We have examined international trends; this means that we have not taken national developments - such as setting up regional implementation services - into consideration.

Preconceptions on supervision and supervisory authorities

We'll start on a cheerful note by saying that in addition to all our profitable talks, we've also made a list of preconceptions on supervisory authorities - in passing, as it were - which we'd like to share with you:

- ❑ Inspections are inefficient
- ❑ Supervisory authorities work without communicating with each other
- ❑ There's a lot of red tape
- ❑ Supervisory authorities love rules and regulations
- ❑ As long as the facts are right on paper
- ❑ Supervisory authorities have no idea what they're supposed to be supervising
- ❑ Supervisory authorities have no inside knowledge of the market
- ❑ Supervisory authorities protect established interests
- ❑ There's too little monitoring of the system and too much supervision of details and individuals
- ❑ Underestimation of risks
- ❑ Too much faith in businesses

- ❑ Supervisory authorities work through lists (tick-off supervision)
- ❑ Supervisory authorities are a hindrance to creativity and free market forces
- ❑ Costs of supervision are too high
- ❑ Supervision is not stringent enough: it's too soft
- ❑ Too much tolerance, punishments aren't severe enough
- ❑ Lack of vigorous action
- ❑ The good ones get caught out while the bad ones go scot free
- ❑ The number of fines imposed detracts from the real work
- ❑ Private supervisors are much better (expertise, efficiency, follow-up)
- ❑ Supervisory authorities don't know enough about their subject

And just to balance this list, here are the preconceptions and opinions of supervisory authorities themselves:

- ❖ Too many regulations to enforce and not enough manpower and resources to do this.
- ❖ Supervision is (politically) undesirable and is incorrectly regarded as a 'necessary evil'.
- ❖ We'd like to enforce the regulations, but we aren't allowed to these days. Everything has to be lenient.
- ❖ Supervisory authorities have to account for their added value to an increasing extent.
- ❖ If an incident occurs, it's always the supervisory authority's fault.
- ❖ People under supervision have to be treated like customers, but they aren't.
- ❖ What do you mean, supervision based on trust? Supervisors should

- work from a practical and healthy distrust if they want to do their job properly.
- ❖ System supervision has come into being due to a lack of time and know-how.
- ❖ Identifying and dealing with problems results in more trouble than appreciation.
- ❖ Since policy takes very little account of the enforceability of regulations, supervisory authorities have to resolve this themselves.
- ❖ Although the inspectorate keeps introducing efficiency drives, it's being increasingly assessed on its effectiveness. How on earth can you make this clear?

So why do we need supervision?

People complain a lot about supervision, but regulations don't enforce themselves, or at least not as far as everyone is concerned. And this can result in serious consequences. The following pictures serve to illustrate this:



What is supervision?

Before we talk about the trends we discovered during our research, we'd like to take a brief look at how we define supervision and the nature of its environment.

The most common definition of supervision is: "the compiling of information concerning the question of whether an act or a matter fulfils the relevant requirements, the subsequent forming of an opinion on this question, and possible intervention as a result." This definition therefore includes enforcement as well.

Generally speaking, the main aim of supervision is regarded as the overcoming of market failure. Regulators set restrictions in cases where social interests could be damaged by the market, and supervisory authorities make sure that these restrictions are enforced.

In this respect, supervision can serve a number of purposes: 1) supporting ministerial or public responsibility, 2) achieving the intended socially desirable effects, 3) fulfilling the minimum quality requirements, 4) limiting risks, and 5) preventing fraud and unfair competition (exceeding moral standards).

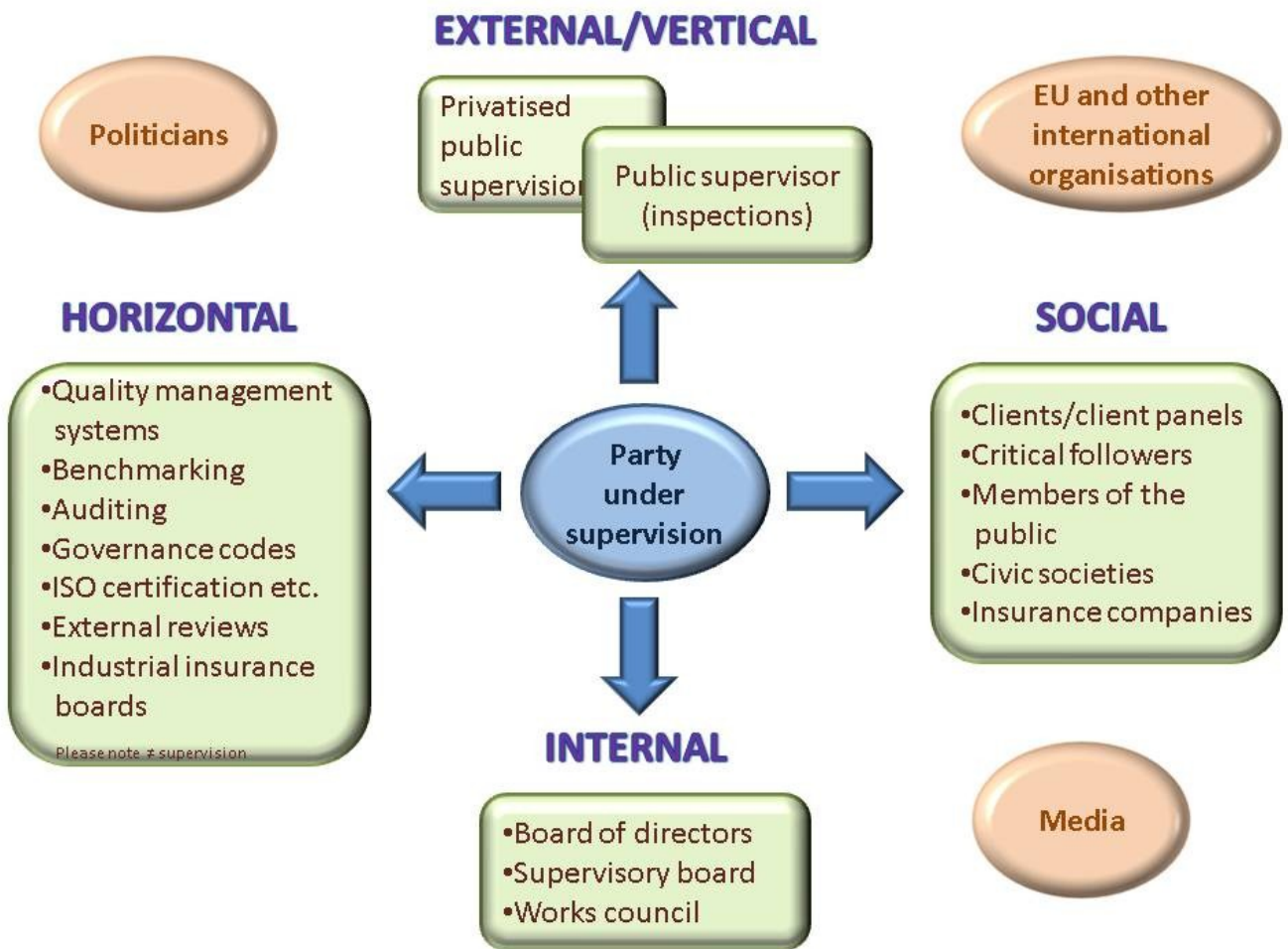
Intervention can take place in many ways. We can divide this into three main enforcement incentives: 1) providing know-how (information), giving help (compliance assistance), or 3) applying pressure.

Developments in supervision are strongly influenced by incidents. If a crisis occurs, the authorities introduce new (and more stringent) regulations and new and tougher forms of supervision. Whether the crisis in question is BSE, a collapsing balcony, fraudulent company directors or the credit crunch, they all give rise to new regulations and supervision. One drawback is that if no incidents occur for a while, cutbacks in supervision are made fairly soon.

Where does governmental control come in?

Governmental control is one factor in a wider range of checks and balances. It's a good thing to bear this wider range in mind. We can divide this into vertical responsibility lines (public supervisors), horizontal performance incentives (quality management systems such as ISO, benchmarking, auditing, etc), social incentives (clients, followers, civic societies), and internal supervision (board of directors, supervisory board, works council).

Contrary to popular belief, these are not communicating vessels, since each type of supervision serves a different purpose. Vertical supervision serves public interests, horizontal supervision is intended to promote efficiency and keeping the sector 'clean', social supervision is aimed at immediate self-interest, and internal supervision serves to keep businesses on course and to guarantee profit maximisation and shareholder value.



INTERNATIONAL TRENDS

Introduction

One thing in particular has become clear to us: supervision (and people's views on it) is strongly influenced by the spirit of the times. Public preference for the way in which supervision and enforcement are carried out swings like a pendulum from one extreme to another as the years go by. These days the pendulum is swinging towards more stringent regulations, more repression and deterrence, more policing and more government action. This is at the expense of (respectively) performance-based norms, prevention and reliance on compliance, supervisory authorities' advisory and consultative role, and leaving it to the market. However, we should bear in mind that the pendulum can swing back in a few years' time, possibly even within the next decade.

This means that supervision is extremely sensitive to contexts and incidents. Developments in supervision and the strategies that supervisory authorities prefer to use, as well as their pace, differ considerably according to the relevant sector. This means that each incident almost automatically results in the deployment of new supervisory instruments (such as the body scan at Schiphol Airport).

Nevertheless, we can distinguish four international trends at a higher level of abstraction, which all supervisory authorities will have to deal with in principle during the next few years.

TREND 1: GLOBALISATION

- ❏ Harmonisation of regulations and supervision
- ❏ International regulations
- ❏ Level playing field
- ❏ International trade and markets
- ❏ International compatibility
- ❏ Europeanisation
- ❏ Globalisation
- ❏ Increase in scale
- ❏ Expertise

- ❏ Efficiency
- ❏ Increased 'soft control' by the EU and major powers
- ❏ Cross-border Internet trade: who supervises this?
- ❏ Complexity of the supply chain

Supervision is becoming increasingly internationalised in all respects, mainly within Europe but also on a global scale. Regulations are being harmonised to an increasing extent, while supervisory authorities are setting up international networks, entering into cross-border cooperation and coordinating their work.

Since commercial activities and production processes are undergoing globalisation, national supervision will no longer be adequate. Nations as well as (internationally-operating) businesses and business sectors are demanding a level playing field on both sides, which also means that actual supervision will be equalised to a greater extent in Europe and the rest of the world. Countries where supervision is lagging behind on average will have to pull up their sleeves, while those who lead the field may possibly have to slow down a bit.

In addition, EU member states' second-line supervision of the enforcement and monitoring of EU legislation within Europe will intensify during the coming years. However, it is doubtful whether member states will readily relinquish their autonomy in a large number of areas. It is inevitable that supervision of EU institutions will substantively increase (this is also known as soft control), and the question is therefore to what extent this will result in new and formal supervisory bodies at European level. Due to considerable political pressure, other international organisations are gaining control of national regulations and supervision (such as e.g. pressure from the United States to make bank and credit card data available for inspection in order to combat tax fraud and the financing of terrorism).

There are nevertheless innumerable European and international first-line supervisory authorities, such as those engaged in EU monitoring of fishing, medicines, food quality, aviation and free market forces; this number will slowly but surely increase in the future.

With respect to increasingly complex industrial operations, it is practically impossible to obtain and maintain sufficient expertise at national level. Supervisory authorities are obliged to organise and hire this know-how (on e.g. nuclear energy, complex chemistry, gas and oil extraction, or aviation) at international level. Since many people and organisations regard the supervisory authorities' lack of sufficient 'real' (technical) expertise as a problem, globalisation may provide a solution to this, at least in part.

There are also opposing forces in existence. For example, individual nation states profit from the ability to control their own supervisory systems, since flexible supervision influences countries' attractiveness as a business location and their competitive position compared to that of neighbouring countries. However, this seems to be a rearguard action which can only delay the trend, but cannot stop it.

TREND 1: Increased international cooperation and exchange of knowledge and the creation of European and international supervisory authorities who will take over first-line supervisory duties as well as carrying out second-line supervision of national supervisory authorities.

TREND 2: MORE REGULATION AND MORE SUPERVISION

- ✚ A new balance between the government and the market
- ✚ More supervision
- ✚ A new balance between administrative-law supervision and criminal-law supervision
- ✚ More system supervision
- ✚ More supervision based on risk analyses

- ✚ Self-regulation, auditing, benchmarking and certification will remain in use
- ✚ However, there will also be an increase in other 'performance incentives' such as quality marks and self-assessment.

Although governments and organisations all over the world have been discussing deregulation, more efficient supervision and limiting the supervision load for years, regulation and supervision are actually on the increase. Moreover, our discussion partners unanimously anticipate that the quality and scope of 'intelligent' regulation will continue to increase as well. Private parties that carry out supervision under public law can play a bigger role here; this trend has already manifested itself to a considerable extent with respect to supervision of the building sector in countries such as Canada and Australia.

The credit crunch, as well as other incidents such as the construction fraud affair, has made it clear that effective supervision is essential. In view of our increasingly complex society, supervision can hardly be left to consumers or to the public as a whole. In addition, citizens' confidence in social institutions and large-scale companies is declining. The public is becoming increasingly unwilling to accept adversity or risks, and it expects technological developments or government intervention to curtail these. That is why professional supervisory authorities are still urgently needed in the private sector, and also in the shape of governmental control.

Contrary to popular opinion, regulations usually benefit many businesses rather than causing problems, despite the fact that such businesses publicly maintain that the reverse is the case. In the first instance, an occupational group or business sector will attempt to create standards and a level playing field by using horizontal instruments, but if self-regulation is undermined by globalisation and anonymisation (e.g. by so-called free-riders or one-shooters), there will be an increasing demand for government regulation. In this respect, government regulations often keep newcomers on the market at a distance and create equal competitive conditions among existing market players.

A great deal of discussion is going on with respect to system supervision. Although a large number of people criticise this, many others support it, but both groups anticipate that this type of supervision will assume large proportions. Incidentally, system supervision is used to a greater extent in the Netherlands than in neighbouring countries. However, for a number of reasons, system supervision cannot replace direct supervision, and many people have warned that system supervision cannot be carried out without direct supervision. The use of risk analyses and responsive regulation is also on the increase.

In this connection, we should mention that criminal-law supervision will also gain ground, although neighbouring countries are not accustomed to the interaction between administrative-law supervision and criminal-law supervision customary in The Netherlands. This implies more focus on criminalisation and repression and less on prevention.

Another trend is the importance of applying new technology, knowledge management and data processing. Supervision work is becoming digitised to a considerable degree, and in this respect, information at private enterprises (such as telecom, Internet, bank details etc) will be used to an increasing extent. Businesses will be more frequently obliged to compile data actively and to place these (digitally) at supervisory authorities' disposal.

Opposing forces also apply to this trend, such as the interminable debates on the supervision load, administrative costs, efficiency and targets. Nevertheless, this will not be able to stop the increase in scope of all the different types of supervision.

TREND 2: The importance and scope of government regulation and governmental control and of other performance incentives (internal, horizontal and social supervision) will increase during the next few years.

TREND 3: CHANGING RELATIONSHIPS

- ❏ Increasing level of information for consumers and the public
- ❏ Increasing transparency
- ❏ Higher degree of organisation for consumers
- ❏ Interest brokers and interest groups
- ❏ Image and reputation interests
- ❏ Councils comprising interested parties and client panels (legally enshrined or otherwise)

- ❏ Supervisory authorities' use of consumers (Independent Post and Telecommunications Authority, consumer authority)
- ❏ Competition with the public as supervisory authorities
- ❏ New technology serves to increase organisational potential
- ❏ Supervisory boards' position is becoming increasingly important

The diagram on page 4 shows the various types of supervision. All these types of supervision will increase during the next few years, which also means that a new balance will have to be found.

Internal supervision will play an increasingly important role. We refer here to the position and professionalisation of organisations' internal management, and in particular to that of supervisory boards. Although this was merely an honorary post up till quite recently, in which members of supervisory boards devoted one evening every two months to their task, these boards are now taking their duties far more seriously. It should be noted here that they supervise the achievement of the organisations' objectives, their business operations and their performance. They primarily serve the organisations' interests, which do not invariably coincide with social interests.

Horizontal supervision (which some people feel should not be referred to under this name) is likewise on the increase. Some examples of this are the deployment of quality systems such as mutual benchmarking in a given branch of industry, ISO and other types of certification, internal and external audits and reviews, and the devising of professional and corporate governance codes. Although this is sometimes done for internal reasons, it is often instigated by national and international authorities under the threat of government regulation. These horizontal supervision systems are less likely to be independent, but will be subjected to (second-line) governmental control more intensively than before. This is due to the system errors discovered during supervision of the financial sector. Incidentally, organisations are still frequently warned against the risks of this privatised type of supervision (e.g. integrity, objectiveness).

Social supervision has assumed large proportions, and we anticipate that it will continue to do so. Citizens, consumers and critical followers keep a watchful eye on companies' business practices (as well as those of the government) for a variety of reasons. Although organising opposition used to be a complicated and costly business in the past, it has now become easy thanks to the tremendous spread of the Internet, and interest brokers have even turned this into their profession. Access to information and the media has also become much easier, and large-scale companies' image and reputation interests have ensured that these (occasional) initiatives have a great deal of influence. Amendments to consumer law (such as the Convention on Access to Information, Public Participation in Decision-making, and Access to Justice in Environmental Matters) have also provided consumers with a means of redress by allowing them greater access to the courts. Consumer law in the United States has already forced a number of manufacturers to make changes in their products and production processes. Moreover, businesses are paying more and more attention to interest groups such as the Association of Home Owners, the

Association of Stockholders, the Consumers' Association and environmental associations, and enter into consultations with these groups in order to avoid legal proceedings. Finally, the role of rating agencies (for the valuation of shares and bonds) and insurance companies is just as important as ever, and they have a great deal of influence on corporate behaviour. Private individuals and interest groups make use of these bodies to put pressure on businesses and companies.

The fact that there are 16 million supervisory authorities in The Netherlands means that the state inspectorates have a large number of allies, and they will also make more intensive use of their services. However, since these supervisory authorities also provide competition for the inspectorates, the work will have to be coordinated accordingly.

And finally, we have vertical supervision. The scope of this type of supervision is generally expected to increase as well, and system supervision will probably occupy an even more prominent place within the vertical supervision category. In connection with this, certain forms of outsourcing public supervision deserve our attention, in which private enterprises take over (part of) the public supervisors' role. This is already common practice in countries such as Australia and Canada. In the United States, there is an obvious trend towards 'multiple oversight', in which a number of supervisory authorities cover the same field and therefore ensure double supervision.

TREND 3: Developments in horizontal and social supervision in particular have had an effect on the position of governmental control. On the one hand, they will start competing with one another, but at the same time, they will make more use of one another and will serve to reinforce one another.

TREND 4: THE SUPERVISORY AUTHORITY UNDER SUPERVISION

- ❖ Costs and benefits of supervision
- ❖ Supervisory authorities are blamed in the event of an incident (liability)
- ❖ A large number of (economic) interests
- ❖ More efficiency and transparency required
- ❖ Establishing the benefit of supervision

- ❖ Tension between supervision and policy
- ❖ You can never do anything right
- ❖ Not all types of supervision are the same
- ❖ Unbundling of tasks (e.g. Netherlands Competition Authority, De Nederlandsche Bank) instead of having supervisory authorities and regulators rolled into one

The previous three trends might give rise to the idea that supervisory authorities will have a cushy existence during the coming years. Even if this were true, it is by no means as cushy as it seems. Even though supervision is a growing sector, it will always have a negative image and will have to justify its right to exist and its added value time and again.

To start with, not only 'the culprit' is to blame as soon as an incident occurs, but the supervisor is also held responsible almost immediately after, since he obviously failed to

perform his duties properly. Even though supervision cannot guarantee that nothing can ever go wrong, the reflex described above is extremely strong (also in a political sense). In addition, the question of liability is becoming an increasingly important factor. Claims for compensation are not only lodged against the 'culprit'; supervisory authorities are frequently held liable for insufficient supervision as well. Although not many claims are allowed at present, recent developments show that the significance of this is on the increase.

And supervisory authorities still encounter a lot of difficulties, even if no incidents occur. After all, what is the point of supervision if everything is running smoothly? That is why politicians soon make cuts in supervisory authorities' tasks and scope, particularly if they appear to constitute a hindrance to commercial activities.

Supervisory authorities are forced to increase the degree of transparency and public access in their work and in the results of their investigations. They need to do this in order to 'prove' their task and their effectiveness. The point here is not that supervisory authorities write down their output, but that they specify the outcome of their work in terms of achieving social objectives (fewer illegal toxic waste discharges, cleaner air, fewer deaths, less social costs). Therefore, it is important that supervisory authorities have a clear picture of the social objectives they are aiming at, and that they adjust their performance accordingly.

But transparency and public access also constitute an eminently satisfactory instrument for forcing businesses into compliance. Businesses that are assessed unfavourably can no longer obtain loans from banks, and their image suffers as well. Direct links with the Public Prosecution Service and clear agreements on when supervisory authorities may or may not be liable to prosecution also serves to make supervision more effective (this is known as the 'big stick' in the supervision world). Nevertheless, there is still some resistance to this in practice; inspectorates no longer compile annual reports, and politicians show little interest in supervision apart from the inconvenience it causes.

TREND 4: Supervisory authorities will increase transparency with respect to their activities, and ensure greater public access to the results of their investigations. In this respect, political and social pressure will facilitate the seeking of options for clarifying the social and economic benefits of supervision.

Challenges facing supervisory authorities

- ✚ Be aware of what you stand for and make this clear. Formulate your intended social outcome.
- ✚ Ensure more transparency and public access in your supervision duties and reports.
- ✚ Clarify the (social) benefits of your supervision and enforcement.

- ✚ Invest in international cooperation.
- ✚ Devote a great deal of attention to obtaining and maintaining (technical) expertise. Do this at supranational level if need be.

- ✚ Make use of the public, consumers and civic societies wherever possible.

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APPENDICES

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