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Regulation

The Social Control of Business between Law and Politics

Michael Clarke

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CITIZENS' FINANCIAL FUTURES
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Regulation

The Social Control of Business between Law and Politics

Michael Clarke
Senior Lecturer in Sociology
University of Liverpool

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Preface

This book is an attempt to provide an introduction to the literature on regulation, drawing particularly on the empirical studies of sociologists and political scientists which have investigated the workings of regulatory institutions and regimes. Its object is to identify some leading themes and issues and to provide a comparative perspective which is often lacking in the empirical literature. This posed a choice between severe abstraction and the use of fairly extended examples. The former has the drawback of being inaccessible, particularly to the reader unfamiliar with the literature. The latter involves necessarily brief accounts of a limited selection of studies, though it does allow points to be illustrated and give an introduction to the empirical research, which is quite diverse. I decided that the latter was the preferable strategy, in the awareness that those familiar with the literature will almost inevitably disagree with my selection of examples. For them I hope that examples and analysis drawing on fields other than those in which they specialise will prove stimulating. I would urge students unfamiliar with the literature to supplement the illustrations in this book with a careful reading of at least a limited number of empirical studies.

I am grateful to the Department of Sociology, the University of Liverpool, for giving me a semester's leave to complete the writing of this book and to Annabelle Buckley of Macmillan for commissioning it. Lorraine Campbell typed several drafts of the outline which was essential to co-ordinating my ideas, and Paula Ferrington typed the bulk of the text with great speed and accuracy. My thanks to them both. Finally, I am most grateful to Liz Kingdom and Glenn Morgan for their comments on a draft of the text.

MICHAEL CLARKE
Liverpool

Introduction

What is regulation?

It is a commonplace observation that the motor-car has made offenders of us all, and it is true that many of us have convictions for traffic offences. Many of the commonest, however – speeding, parking – are now dealt with by fixed penalty notices, and a wide range of offences, including driving without insurance and drunken driving, are dealt with by the imposition of penalty points on our licences as well as a fine, with an accumulation of points leading to the loss of the right to drive. In practice most of the energies of traffic police are devoted to attempting to ensure drivers' safety and smooth traffic flows. Even contacts with the public which are not solicited for assistance more usually involve paternalistic advice and admonition, rather than sanctioning. Only real excesses, such as theft of and from cars and attempts to evade police enquiries by flight involve real repression, with the police deploying a wide range of communications technology (radio, video cameras, thermal imaging, spotlights, loud hailers) in a coordinated pursuit of the motorist, sometimes with a helicopter as well as cars. Though most motorists probably do not refer to it after passing their driving test, they are required to familiarise themselves with the highway code in order to obtain a licence and this, like most traffic policing, accentuates the positive, providing a model for safe driving as well as clearly identifying malpractice. Coupled with continuous improvements in highway engineering and car design, the outcome in Britain is a fatal-accident rate in the 1990s comparable with that of the 1920s, but with vastly greater traffic flows, often at much higher speeds.

The police, in short, act as a regulatory agency in respect of traffic. The object is not, as in criminal misconduct, to pursue and sanction all significant offences, but rather constantly to improve driver conduct. Even the sanction of suspension of licence and requirement to retake a driving test are regulatory in the same sense: less concern with the criminal law than with achieving good behaviour. While regulation hence implies intervention and has an etymological meaning of subjecting an area of conduct to rules, it is more accurately seen as a process whereby order is achieved in an area which has shown a propensity to disorder to an extent that demands attention. This requires the constitution of a form of authority to identify how ordering is to be achieved, which may be external – the police, in the case of driving – or internal, as most notably in the case of the professions. In either case, however, while there may be some matters that require specific rules – which side of the road to drive on, for example – the objective is collective, agreed, orderly conduct. This requires the understanding of all involved and their agreement. While sanctions are hence necessary for those who, for idiosyncratic reasons, disagree and cannot be persuaded (the alcohol limit is stupid. I'm as safe with double it as most people are with half of it, because I'm used to it), for the majority consent, or at the very least assent in the sense of willingness to comply despite reservations, is the objective. The greater the number of detailed rules a regulatory regime develops, the greater the complexity of the regulatory process, the greater the chance of confusion and objection by the regulated, and the greater the potential for conflict with the regulator. (How many drivers going to France carry a full set of replacement bulbs for their lights as required? Who has not overtaken on the inside on a British motorway as traffic backs up?)

General principles rather than detailed rules are often more effective in achieving understanding and consensus. Thus drivers who observe the principles of alertness, looking before acting, and courtesy to other road-users will not go far wrong. The problems arise from the arrogant and the incompetent who can only be effectively caught by more specific requirements, though English law still has broad categories of offences, such as driving without due care and attention, careless driving, and dangerous driving, as its backbone.

Can we say then that some problems, like traffic, are essentially, if not entirely, regulatory where others, like burglary, are criminal? The answer is that some issues certainly lend themselves to one approach rather than the other, but that there is always a choice of strategy to be made. In part this will depend upon the seriousness with which the problem is viewed and hence the necessity for criminal sanctions and strict enforcement against every offence. In part also it will depend upon the power and legitimacy of those to be controlled. In practice the two strategies, regulatory and criminal, are so different as to be largely incompatible, albeit that regulatory agencies often have powers of criminal prosecution. For the allegation of criminality implies wilful wrong-doing and carries the stigma of conviction in a public court. It will hence be vigorously resisted and due process will be exploited to avoid conviction or to minimise its extent. Proving the allegation will hence be time-consuming and will generate antagonism. Regulatory action, by contrast, emphasises future, not past, conduct. The approach is less to sanction failings than jointly to agree remedies and to achieve understanding and commitment to acceptable conduct. The difficulty which the regulatory strategy involves is hence the potential interpretation of egregious misconduct as unsanctioned, notably by outsiders, and the perception that offenders are 'getting away with it'. The choice and the balance between the two strategies are hence closely involved with matters of regulatory effectiveness.

To sum up so far, then, we can say that regulation involves the constitution of a form of authority, whether internal or external, to achieve ordering in an area of life that has come to attention as showing tendencies to disorder, perversity or excess. Successful regulation involves the consent of the regulated and hence much effort is devoted to achieving and very often to raising standards. Detailed rules are, however, usually also essential to this end in order to restrain the recalcitrant, and a regulator will require sufficient powers to command respect and compliance even in the absence of consent. Nothing is so destructive of effective regulation as the perception that some regulatees are 'getting away with it'.

It follows that regulation is an essentially political process. How matters come to public attention as requiring regulatory intervention is a process of political mobilisation – proposed licensing of pub and nightclub bouncers, of private investigators, and of security guards are current British examples. In the process of regulation there is often extensive interaction between public and private sources of intervention. Occupations subject to regulatory intervention often form themselves into protoprofessional bodies or trade associations and draw up codes of conduct to attempt to stave off state intervention, and at times this may be successful. Even when the state does become involved, the objective of achieving order requires negotiation, not only in the initial stages of establishing the new regime, but in its implementation and revision.

There is an element of self-regulation in all regulation, therefore, and particularly in successful regulation. The regulator may need to exercise its powers to the full extent from time to time in order to command respect, but a continual emphasis on sanctioning leads to resentment and to the development of an adversarial culture among the regulated. This in turn leads to a need to specify everything and so to more opposition to rules, the details of which are burdensome, become outdated and are inevitably inappropriate in some situations.

Regulation is hence a continuous and dynamic political process: sustaining an effective regime requires evolving to meet changing circumstances and involving new regulatees as they arise. It may also involve negotiating with new interest groups as regulation develops – land-owners and residents affected by massive traffic increases associated with 'raves' and 'pop concerts', in the case of traffic regulation. Besides the power of the regulator and the regulatees there is also the power of other interested parties to add into the equation, and this will depend greatly on the extent to which they are effectively organised and mobilised.

Some readers will have noticed that several related matters have not so far been mentioned. Discussion of regulation has implicitly assumed that intervention invariably involves ordering conduct that is nonetheless tolerated in principle. Surely, it will be said, some is not tolerated. Thus pornography in Britain is regulated by the law on obscenity, by the British Board of Film Censors, by the Broadcasting Standards Council and the Independent Broadcasting Authority, and by the licensing of sex-shops by local authorities, as well as by other agencies. This should alert us to the fact that regulation is as often diverse as it is uniform. In the case of obscenity this battery of agencies regulate what is to be shown and sold, where and to whom, in respect of degrees of obscenity. Pornography involving children is, however, banned outright, and it is an offence not merely to display or sell it, but to own it. The legislation was the achievement of a private pressure group, the National Viewers and Listeners Association, then headed by Mrs Mary Whitehouse. Regulation by exclusion or ban is by no means unusual and may be gradual as well as instant – compare the cases of leaded petrol, officially identified as being phased out, and nuclear power, now under such sustained pressure as to be likely to be phased out.

At the other extreme in terms of powers from the ban lies mere monitoring. In between lie supervision and licensing. The continuum of powers that a regulator has reflect what is seen to be necessary for the job, and the dangers of inadequate regulation on the one hand and oppressive intervention on the other.

The notion of regulation as interference or as over-zealous directs our attention to the issue of ideology, and beyond it the state. If to regulate is to intervene, establish authority and seek to achieve order, the potential for conflict with freedom of action is evident. In industrial societies based on political individualism and the market, sensitivity to such matters is great, though, as we shall see shortly, more complex than it is often made to appear. The debate which regulatory intervention always involves is whose interests, besides those directly involved as practitioners in a particular area, are affected and hence should be represented, as well as the balance between the various interests and between freedom of action and restraint. To anticipate, regulation has shown a powerful tendency since industrialisation to increase and extend, and interests other than direct actors to be increasingly widely represented. Thus the historic habit of riverside manufacturers and towns to discharge their waste into rivers has been subject to increasingly rigorous restraint in the interests not only of such established competing interests as water companies seeking to extract drinking water, but anglers, and the general public enjoying the amenity value of rivers. Such has been the sustained pressure of the regime, with constantly increased standards in respect of authorised discharges, that salmon have been reintroduced to the Thames after an absence of several hundred years. Regulatory intervention may hence not be concerned simply with establishing order and standards initially identified. In many cases standards are continually raised and the achievement of one level creates the basis for debate as to what to aim at next.

Sensitivity to regulation as interference should not blind us either to widespread private regulation, which can be equally powerful. Not only professional bodies, but cartels can acquire substantial effective, even if at times informal, powers, and in many areas private regulation has preceded public and continues to accompany it. Notable examples are trade and industrial associations. Increasingly, however, the state has taken responsibility for regulation and the 'nanny' state has been the butt of much ideological opprobrium. The state has been drawn to intervene in ever more areas for reasons that go to the heart of the political, economic and social development of industrialised democracies. A brief account of how this happened will be provided in the next chapter.

Organising an account of regulation

To sum up then, regulation is a form of ordering involving the constitution of a form of authority in order to achieve the practical management of competing interests. Much regulation is of markets and their participants. It is sector-specific and tends increasingly to be sub-sector-specific. Regulation is inherently dynamic, responding to technical, social, economic, and hence political change. It can be public or private. There is a genuine but increasingly dated debate about whether to regulate, the real issue being whether ordering is achieved by public intervention or, usually already existing, private arrangement. There is hence constant debate about regulatory effectiveness, sometimes masked by an ideological debate about costs. All this has given rise practically to a bewildering variety of regulatory institutions and objectives. Table 1 gives some idea of the diversities involved.

The examples in Table 1 are arbitrary, but may stimulate the reader to make qualifications and additions, e.g. many industries are subject to different regulators for different purposes and some are subject to different regulators for quite similar purposes – the Broadcasting Standards Council and the BBC Complaints Commission could be added to broadcasting, and a variety of ombudsmen to retail finance. To enter this invidious process is to recognise the futility of attempting to classify regulation either by industrial sector or by kinds of objectives. Both classifications can be undertaken, but only at the price of leaving long tails of unclassified additions. Much the same applies to attempts to classify regulatory agencies as private, public or of a variety of mixtures. Such an enterprise will be defeated not merely by the variety of nuances in the constitution of agencies but by the apparently countless numbers of agencies. No doubt a definitive list could in principle be compiled, but it would become almost instantly out of date. To approach the matter from a slightly different angle, the Cabinet Office in 1993 identified several different types of 'non-departmental bodies' or quangos. There were at that time 358 executive agencies with both staffs and budgets such as the Agricultural Training Council and the Higher Education Funding Council for England and Wales. Together these employed 111 300 and their budgets totalled £15 410 m. Also identified were 829 advisory bodies and 68 tribunals. These are evidently not all regulatory agencies, but most if not all have some regulatory function. And all are quasi-state bodies; private ones are excluded. Nor is it possible to identify a range of functions or purposes exercised by regulatory agencies. A collection of excellent studies of nine agencies suggests five functions, without claiming exhaustiveness, and the five suggested are of doubtful coherence (Baldwin and McCrudden 1987). Further, the examples in Table 1 are British and indeed largely English. Other countries have other priorities and other traditions and cut the cake differently.

Table 1 Examples of regulation

Sector	*Intervention on*	*Agency*	*Object(s)*
Utilities	Prices and monopoly	OFWAT OFGAS, etc.	Competition, fair prices, secure service, customer safety
Banks, building societies and insurers	Financial prudence	Bank of England, Dept of Trade & Industry, Building Soc. Commission	Security and stability
All public companies	Mergers, acquisition and pricing and market sharing agreements	Monopolies & Mergers Commission and the Office of Fair Trading	Industry and public protection from monopoly
Retail investment product providers	Sales practices and information disclosure	Personal Investment Authority	Investor protection
The professions	Competence and probity	Professional bodies	Maintenance of service standards
Manufacturing industry	Biological and chemical hazards	Pollution Inspectorates	Pollution control
Nuclear power industry	Radiation	Nuclear Inspectorates	Minimization of radioactive pollution
Retailers	Hygiene	Environmental Health Officers	Public health
Retail trade	A variety of consumer standards	Trading Standards Officers	Consumer protection
Broadcasting	Radio and TV wavelengths	Independent Broadcasting Authority, Independent Television Commission	Broadcasting quality
All larger companies	Audit	Accounting practices	A true and fair view of company affairs
Charities	Quasi-audit	Charities Commission	Information, probity and charitable purposes

(*cont'd*)

Table 1 (*Continued*)

Sector	*Intervention on*	*Agency*	*Object(s)*
Government Depts	Expenditure	Audit Commission	Value for money
Water	Quality and quantity	National Rivers Authority	Quality and flow of water
Casinos	Various	Gaming Board	Minimization of addictive gambling and casino abuses of gamblers and of taxation
Sport	Rules of competition and play and league membership	National and international sporting bodies	Maintenance of standards of competition and sporting play

Nonetheless from the point of view of academic enquiry, the requirements in each sector and industry and in each regulatory domain for technical expertise to reach an appreciation of a regime has proved a source of almost inexorable pressure to create practical areas of enquiry. Coupled with the differing styles and objects of the various interested academic disciplines, this has led to a limited number of foci combining aspects of certain industries and combinations of disciplines.

The last group in Table 2 effectively concentrates on physical hazards deriving from materials processing industries, and is the largest related body of work, though in practice there is a great deal of specialisation by practical interest, by industry and by discipline, as there is in all research on regulation. A comparison with the earlier list of examples of regulation immediately suggests areas not covered, though good work has been done in some areas and in some disciplines, both in areas identified above and in others I have mentioned. A comprehensive account of current interest and expertise is hence clearly beyond the scope of a short book. Further, the disparity in disciplinary approaches, particularly as between economics and law insofar as it has allied with it (Ogus 1994), and the rest is so great as to defy easy bridging. Like what has been written so far, the chapters that follow will be based on sociology, political science, criminology and to a lesser extent law.

Table 2 Regulation: academic enquiry

Industries	*Disciplines*	*Issues*
Utilities	Economics and law	Prices, profits and monopoly / oligopoly
All industries potentially	Economics, sociology, law	Cartels
The professions	Sociology, accounting	Professional self-regulation and increasingly the issue of professions as trade associations v. disciplinary probity and client redress and protection
Financial services	Sociology, criminology, political science, economics	Control of fraud and abuse, investor protection, stability and security of markets and institutions
Coal and oil extraction, power-generation, chemicals, pharmaceuticals, food, water	Sociology, criminology, political science, law, economics	Worker health and safety, environmental pollution, product safety and reliability disasters / crises

Chapter 1 will outline the historical sources of modern regulation in the rise of industrial society, which greatly and continuously extends the hazards to which workers and populations are exposed through new industrial processes and products. Industrialisation leads to democratisation and this further increases the capacity of the public to demand regulatory management of hazards of all kinds, which pose an increased problem because of the social and cultural differentiation that comes with industrialised democracy. Since people lead lives that are increasingly different from others in the population, relations between groups cannot be taken for granted and require formal management. Finally, the advent of the affluent consumer society since 1945 has given an added impetus to regulation as public confidence in the constantly proliferating new goods and services needs to be sustained, and the consumer is less and less equipped to make reasoned judgements of safety and quality, but more educated and politically assertive. Although the state has played an ever-increasing role in regulation, it should not be assumed that regulation is to be identified with state intervention. Private regulation has in most cases preceded it and is still very powerful.

Chapter 2 will consider private regulation: cartels, clubs and industry associations. In some respects, notably cartels, there are important topics in their own right here, with lessons for understanding how a market economy works and hence is regulated. More generally however, this chapter takes off from the point made above that private regulation normally precedes public and may well supersede it, given the opportunity. There are a number of examples of this, some benign, others less so.

Chapter 3 looks at a special example of private regulation, that exercised by the professions, and highlights the difficulties they have, especially in disciplining their members and in achieving redress for wronged clients and the pressures they are currently under to abandon their entirely self-governing mode of regulation. This chapter will also consider the process of professionalisation seen as a claim by an occupation for exclusive rights to regulate itself based on its expertise and the social and economic importance of the services it provides.

Chapter 4 looks at state regulation and the difficulties it faces: the inevitability of quangos, the difficulties in allocating powers and allowing practitioner-involvement without inviting capture and of diversifying to local levels as against concentrating power in a central agency. The issues of the size and power of the state and its accountability will also be addressed here as an issue parallel to that of the development of regulatory self-interest, the tendency of agencies once established to seek to entrench and expand themselves. The issue of 'who regulates the regulator' and the role of audit in achieving this will be reviewed.

Chapter 5 shifts the concern from the basis of regulation, whether state or private, to making it work, and considers the problems of compliance. The uses of different sanctions, the role of training, capacities and tactics of enforcement, relations between practitioners, regulators and the state are relevant here in identifying standards and achieving consensus and the motivation by institutions and others to meet them.

Chapter 6 widens this concern in the recognition that compliance does not entail regulatory effectiveness. If a regulator is not clear-sighted about objectives and the contingencies arising in achieving them, the results can be disastrous. The US Savings and Loans débâcle is one such instance, and the regulation of retail financial investment in Britain almost another, whereas the US Food and Drug Administration suggests how failures can give rise to effective reforms. Changes in regulatory regimes – in size, remit, powers and strategy – are hence associated with the issue of effectiveness. Effectiveness is the key test of successful regulation and determines whether it is equitable and beneficial, or burdensome and confusing. An analysis of what effective regulation requires is offered in the light of examples.

It is increasingly difficult for regulation to be effective if it is limited by the boundaries of nation-states. The globalisation of trade and communications makes multi-national and international regulation increasingly necessary, yet truly international institutions are comparatively few, and many of them are weak. The tensions between the continuing predominance of nation-states and the need for international regulation is the topic of Chapter 7.

Finally Chapter 8 considers the future of regulation and so takes us back to the general concerns of Chapter 1. It is reasonably safe to conclude that the expansion of regulation is far from over. One large question is how far regulation will need to extend on a paternalistic model to protect the rights of those who cannot fend for themselves, and how far people can be relied upon to look after their own interests, or taught or cajoled to do so. How far are matters determined by the source of the problem, e.g. by the workings of an industry of which the public may know and understand little but which exposes them to a pollution hazard, or by the seriousness of the threat but the relative unlikelihood of its arising, BSE being a problematic case in point? Regulation by political panic may not be the wisest route, but what if the alternative is capture by industry interests? As indicated above, these issues are often not ones that can be successfully addressed solely at the traditional level of the nation-state. Regulation will increasingly have to be international if it is to be effective. Improving communication and harmonising regulatory regimes to this end will be one of the greatest tasks of the twenty-first century.

1
The Rise of the Regulatory Society

Regulation has been a feature at least of urban if not of all societies in a limited degree. The quality and price of products and standards of craftsmanship were regulated by the guilds in medieval England and the quality of German beer has been regulated since that time. It is only in the latter part of the twentieth century, however, that regulation has become a substantial and proliferating feature. The rise of regulation and the reasons for it can be understood by conceptualising developments in three broad phases, though just as regulation predated all of them in limited degree, so the boundaries between them must not be identified in hard and fast terms.

The first phase, roughly encompassing industrialisation up to the end of the nineteenth century, saw the establishment of linked political, economic and legal institutions. Industrialisation purged the remnants of feudal distinctions and established the market and freedom of contract for all in it. Industrialisation ushered in a key feature of modernity, namely constant economic change and an ever-diversifying division of labour and technological innovation, accompanied by endless expansion of wealth and prosperity, albeit unevenly distributed. Individualism became established as a central political, economic and moral idea: markets were seen as composed primarily of competing individuals who were given equal rights before the law and whose rights of decision-making and integrity were increasingly required to be respected, along with a moral expectation of individual responsibility and self-help.

Along with these aspects of individualism, however, went an increasingly powerful tendency to individual political expression. A freer market in goods and services led to an expanding market in moral and political ideas, and the notion of individual responsibility in the marketplace and equality before the law led to demands for political representation. These were reinforced by the extreme inequalities that persisted in the midst of the new wealth. Poverty had always been taken for granted as an inevitable feature of civilisation, since economic margins had always been fragile. With the sustained economic growth produced by industrialisation, however, the traditional assertion that 'the poor are always with us' became a less acceptable assumption. With the mass of the population now only too aware of the insecurity of their positions as hourly, daily or at best weekly contracted workers and the gap between rich and poor wider than ever, demands were increasingly made for rights to full political representation. Enfranchisement became the price to be paid for the capitalist market economy.

Further, however, technology, the means of success of industrialisation, brought with it new dangers. In deep mines and factories contracted workers were subject to appalling degradation and exploitation and suffered increasingly from the hazards of new industrial processes. After some opposition, the first Factory Acts were introduced. Their requirements for safer working conditions were respected, on the whole, by the larger manufacturers, but ignored by many of the smaller ones who could not afford to implement their provisions. It required further legislation, creating a factory inspectorate to achieve uniformity, and in doing so to make a vital point. The introduction of regulation is concerned with the establishing of standards which take account of all parties who are eventually agreed as having a legitimate interest in the regulated activity. This process involves costs. In the case of the Factory Acts, economic costs drove some smaller manufacturers out of business (Carson and Martin 1975). In other instances, costs may be identified more in restraint on freedom of action than in economic and financial terms.

A wide range of regulation affecting the economy followed as industrialisation progressed – for example of gas, water and electricity on the economic side and of the care of criminals and the insane on the social side. The development of an urban, dynamic and increasingly wealthy society with a constantly evolving division of labour that industrialisation produced also required the great expansion of the state at national and notably at local level. The provision of street-paving and lighting, sewerage and clean drinking water could not be achieved without local authorities taking powers to raise taxes and establish standards of public amenity, security and health. By the end of the nineteenth century this remit had come to include public order through policing and education, and the libraries, museums and baths that still stand as monuments to this transformation.

By the end of the century, a largely enfranchised male society was sufficiently well-organised through the trade union movement to give expression to a political programme for the remedy of inequality, whether in radical or reformist terms: communism, socialism and social democracy. By this point, several features of modern society critical to regulation were clear. Economic and technical change were endemic, which posed ever-new hazards for workers, consumers and the wider public from technology, constantly reconfigured the division of labour, and generated not only new skills, but new ideas and interest groups. The achievement of the rule of law, that is the subjection of all to the law with equal rights and responsibilities as citizens, accompanied by enfranchisement, form the basis of the stable, modern, industrialised democracy which the experience of the twentieth century seems to indicate is something close to a universal in human societies. These achievements required the establishment, much against the wisdom of past centuries, of the state at local and national level, on an unheard-of scale. In the past a large state had been taken for granted to be a recipe for the expropriation and oppression of the population; now it was seen to be essential to the progress of society and economy (Atiyah 1979).

Formal rights of citizenship did not, however, lead to practical, assertable rights, which widespread poverty and ignorance still frustrated. Out of this was born the social democratic agenda which saw the state as the principal instrument to provide real citizenship rights for all, through the provision of housing, education, health care, pensions, unemployment and sickness pay and subsidies for the arts and leisure. In an uneven pattern, punctuated by economic and political crises – two world wars and the interwar depression – socialists and social democratic parties and their 'liberal' counterparts in North America vastly expanded the state to act as the guarantor, if not the direct provider, of health and security for all. This second phase, roughly between 1900 and 1960, hence saw the emergence of the state as a central actor: as a vast employer itself, as the basis for greatly increased taxation, and as the benefactor of the masses. It was a period that saw the rise of a statist ideology that portrayed it as omnicompetent, staffed by experts who would guide the society and economy in all aspects. It was also a period which saw, besides the establishment of state socialism in Russia, the achievement of comprehensively planned economies in Western European countries in the Second World War.

From a fin-de-siècle vantage point, the remarkable feature of this period, despite crises and catastrophes, was its extraordinary long-term success. Despite the vast growth of the state, the economy expanded fast enough to fund it, and with the sustained economic expansion of the post-1945 period accompanied by a comprehensive welfare state, a transformation took place. The occupational structure shifted so that the manual working class became a minority, and even more strikingly the managerial and professional classes showed a growth rate sustained even after overall economic growth subsided in the 1970s. Health improved, education expanded incessantly and housing standards rose along with general (although not universal) prosperity.

It was this that created the affluent society, a society of consumers, in increasing degrees, if not economically entirely secure, at least economically well-founded, a society with increasingly widespread practical citizenship rights whose citizens were ever more willing to assert them, assisted at times by a lively mass media. This is the third phase. It is this contemporary society, based on consumerism and the demand for security, that can be called the regulatory society (Galbraith 1958, 1969; Perkin 1989; Hobsbawm 1994).

These two features are equally powerful. The origins of consumerism in its regulatory impact lie in the dangers of ever-changing industrial technologies, which have necessitated increasingly close attention to the health and safety of workers, consumers and the general public in respect of air and water pollution, safe manufacturing practices, and product safety. In addition, the great technical complexity of many products means that consumers cannot be expected to be able to appraise quality themselves, and hence regulatory provision for reliability and safety has to be made. Further, the economy is only sustained by consumer confidence and if any product or service is put in question – whether it be beef or personal pensions – the effects of millions of pounds' worth of promotional advertising can be destroyed. The consumer-based economy of affluence is then perforce a regulatory economy, in which consumer rights increasingly prevail and the market principle of *caveat emptor* is compromised.

The contrast between this economically well-founded society and earlier generations points up a shift in attitudes. Even though industrialisation introduced for the first time a society of abundance in the place of scarcity, for the mass of the population this was a mirage. Those inspired by social democratic politics could see how it ought to be, that there was enough for all, but the reality was frequently cyclical unemployment, low wages, poverty, infirmity and lack of education.

Only in the last generation or two has this been overcome and the social democratic agenda shifted from poverty to relative deprivation, and from egalitarianism to stake-holding. That majority which now has at least a degree of economic advantage and in terms of health and of practical citizenship rights, craves security and sees threats in every direction, in the street, in the shops, on holiday, at school, at play, at work, and in banking and personal finance. The threats posed are frequently hard to evaluate for the ordinary citizen and hence security is to be achieved by regulation. Since every citizen is a consumer and every consumer a voter, governments ignore such sentiments at their peril.

This process has recently been given an additional twist by two developments which have shifted the economy in the direction of the market. The abandonment of nationalisation as a strategy to restrain the excesses of capitalism has not led to a simple process of privatisation. On the contrary, controls that were in the past exercised in a comprehensive but largely obscure fashion directly by the state over nationalised industries are now exercised by newly established public regulatory bodies whose objectives and performance are keenly debated (Prosser 1994). The balance of the interests of different parties – shareholders, employees, customers, the wider public – as well as issues deriving from the problems of creating competition in monopolistic industries, is regularly and publicly contested. The outcome of privatisation is not deregulation but increased and clearer regulation.

A similar consequence has arisen from the fiscal crisis of the state. The economic growth that funded state expansion was halted by the oil crisis of the early 1970s, but in any case the expansion of state services was on a rising curve that could not conceivably be matched by sustainable growth rates. Although health services secured healthier populations, medicine advanced more rapidly and an ageing population began to make massive demands for treatment for chronic ailments, in addition to the huge increase in the costs of some modern treatments. Similarly the costs of education expanded. Raised school-leaving ages were accompanied by the expansion of further and higher education, whose costs are much greater than primary and secondary, and by falling class-sizes. The prospect increasingly emerged of a state that would become incapable of funding cradle-to-grave basic services and security. Hence a greater reliance on the market was canvassed as the solution, most notably in respect of pensions. The promotion of private personal pensions was eagerly supported by the financial services industry, only to engender a classic market scandal as overzealous selling to naive customers was seen to seriously disadvantage many. Once again the price of introducing the market, this time by encouraging people to take more responsibility for their own financial security required in practice a guarantee of reliability of products – security, previously underwritten by the state (Clarke 1998b).

It was pointless for right-wing activists to rail against a nanny state and a dependency culture. While it was true that the state had been instrumental in achieving a culture in which security was seen as a leading objective, it was the broader distribution of economic success – affluence, the very affluence that had made possible the rise of the New Right – that generated a concern not to lose what had been acquired and a capacity to see new threats in all economic transactions.

Such a society could be derided as paranoid, but the true face of consumerism is insouciance. It is this trusting participation in a variety of products, services and institutions, in a society that is characterised by a cultural, moral and social diversity engendering a degree of anomie that would provoke a groan from the coffin of Emile Durkheim (1964) that produces bouts of anxiety, particularly when confronted with the market in its more ruthless or incompetent manifestations. For what is undoubted is that the market continues to produce excesses. Did the tobacco industry spend two generations targeting the young for addiction? Does the alcohol industry do this even now? How did a serious fire take place within the first year of operation of the Channel Tunnel? What did the asbestos industry know of the carcinogenic properties of its products and when? How did children's homes become havens for paedophiles?

Two final points should be made in this connection. The constant elaboration of the division of labour and especially its relativising consequences in generating ever greater moral, social and cultural diversity has created extraordinary societies in which vast numbers may come into close proximity or interact for limited purposes without knowing or assuming more than a very limited amount about each other – consider a bus, or a cinema audience for example, or more problematically a nightclub. Where contact is fleeting, diversity may be unlikely to be problematic, but the same problem is posed at the workplace and in voluntary associations, for example. For the purposes of successful interaction in the social context in question the maintenance of trust is essential. If this trust is undermined interaction becomes unsustainable. If, for example, a subgroup is identified as sharing a common view or interest that leads to it pursuing a common and different set of purposes, collective good-will is put at issue. Economic contexts are particularly vulnerable in this respect and confidence in them is especially difficult to sustain where, as described above, participants are often in a position of substantial ignorance because of the technical complexity of the goods and services to be exchanged. To put the point at its most general: the technical complexity and social diversity of a modern industrialised society makes the sustaining of trust a necessity. Much regulation has this as its objective, which is one reason for the necessity for specialist expertise among regulators as well as representatives of the public and for regulatory standards and objectives to be publicly formulated.

Just how difficult it is to regulate a morally diverse society is illustrated by the red-light district of Amsterdam. The tolerance of prostitution within a recognised area was the result of an informal agreement between the mayor, the police and the public prosecutor, despite quite strict legislation, which led to Amsterdam becoming identified with tolerance of the sex industry and soft-drug use in the 1960s. As Punch puts it, 'Dutch society ... remains highly respectable in many ways, but the Dutch have developed a capacity to compartmentalise such issues. There is a kind of pragmatic defence mechanism at work which says we can preserve our respectability by permitting deviance in specific locations.... The law remains as a resource that could be invoked if the trade threatened to spread' (1996b, p. 35). A regulatory regime was hence established in which soft-drug use and the sex trade were tolerated and the police confined themselves to maintaining order and generally kept their distance. The delicacy of such arrangements is highlighted by contemporary Amsterdam, however, in which the sex industry has been taken over by ethnically organised criminals and the drug trade has vastly increased. The consequence is that the red-light district has become a zone of tolerance for very serious crime, including enforced prostitution, illegal immigration, large-scale hard-drug trafficking and serious violence. Social and moral diversity requires tolerance, but tolerance is inadequate unless accompanied by vigilance and a willingness to recognise and engage with change. As in so many areas, a regulatory regime that is appropriate at one point becomes inappropriate with time and social, economic and political change.

There is a further difficulty, however, which derives from the market, not as reality – since, as indicated, nearly all markets are regulated – but as ideology. Market ideology, a variant of the individualism referred to above, permeates the economic life of industrialised societies. It emphasises struggle, competition and success with an acceptance that success is relative – even if others do not necessarily fail, it is essential to stay ahead of the pack. This can produce cultures within businesses, and in some markets and economic conjunctures, which can be aggressive, egotistical, ruthless and exploitative. The 'greed is good' period in American financial culture in the 1980s is one example that was popularised in books and films (Lewis 1989). Derivatives trading in the financial markets seems to constitute a continuing example of the same phenomenon. Individual businesses in almost any sector can be taken over by a similar culture (Fay 1996). The tycoon as a stereotype of the entrepreneur stands as a highly ambiguous icon of market culture. One of the achievements of Richard Branson, for example, is to project an image of dedication to serving the public rather than exploiting it. Robert Maxwell, despite constant bombast about public service, probably convinced few, but succeeded in the marketplace none the less. A fundamental impetus of economic regulation is to engage with this tendency to egotistical excess. The danger, as so often pointed out by defenders of market ideology, is that in the process the energy, determination and imagination of those who drive and develop businesses and markets will be blunted as the price of achieving a bland security for all. Compromise is for the most part hence of the essence of economic regulation.

To sum up then, the rise of regulatory society is the outcome of three long-term trends in industrialised democracies which have become of increasing importance and which in this case has come to constitute a new level of demand for regulation within the last two generations.

- The long-term increase in the risks associated with technology. Not only do these issues constantly proliferate, but as our knowledge of them and capacity to control well-known hazards grows, so our sensitivity to new ones expands.
- The constant change and increasing complexity of the division of labour has given rise to cultural, moral and social diversity and change on an unprecedented scale. This is a standard Durkheimian thesis. The implication for present purposes is the increased need as a result for rights and relations between groups to be more or less formally negotiated in order to sustain social (and economic) trust.
- The rise of affluence and of assertible political rights has led more recently to a sharply increased 'consumerist' demand for security.

Increased pressure for regulation is the outcome not just of the growth of these factors, but of the potentiating effect of their interaction, producing a political climate of enhanced awareness of risks and rights, with regulation seen as the solution.

Social and economic regulation

Although consumerism and the demand for security have economic aspects, it is evident that the pressure is for regulation of both a social and economic kind. It is plainly impossible to deal with both in a short book. To return to the example of policing, the success of traffic policing contrasts vividly with the failure to regulate the social incivilities, boorish, offensive and intimidatory behaviour and minor crimes which blight many streets, places of entertainment and residential areas. The police are looked to as regulators, but it is now becoming clear that efforts must be made on a wider basis – by residents' groups, councils, churches and other voluntary bodies, for example – if progress is to be achieved.

This book, then, will concentrate on economic regulation, which involves the regulation of markets, industries, businesses and occupations. This regulation is subject to constant ideological wrangles, involving notably the hypostatising of the free market as a natural entity which functions best and most effectively when its participants are fully informed, and all are bound by the consequences of their decisions in it, i.e. when *caveat emptor* prevails. It should be recognised that this is an ideal which is rarely if ever realised and that modern markets (and older ones, for that matter) are largely constituted by regulation to get them to work fairly, rather than prevented from behaving 'properly' by regulation. The problem with market ideology, as indicated above, is that it produces a good many casualties and modern society is increasingly disposed to shield its citizens from becoming casualties. The point for present purposes is that the ideology of the free market should be seen for what it is, an ideal and a political ideology, not a natural state of affairs that is forever being corrupted by regulatory intervention. Rather, the actual constitution of markets and other aspects of economic life should be seen as the outcome of a constant political struggle in which an increasing variety of interest groups seek to achieve advantage, whether by ideological ascendancy or by sectional guarantees of security.

This struggle takes place under the eye of the state, which is inevitably the regulator of last resort, i.e. may be required to intervene if matters cannot be otherwise resolved. Sometimes matters are deemed at the outset to be sufficiently important to require state regulation – passenger-aircraft air-worthiness or allocation of radio and television frequencies, for example. On other occasions state involvement may be much more limited. Where the state does intervene it often takes special legal powers and, even where regulation is private self-regulation, recourse to the law for review is sometimes possible (Black 1996). As has been pointed out, however, most regulation involves a substantial element of self-regulation. In addition, the matters to be regulated constantly develop. Both these features mean that, even though regulation is often rooted in law, law has little to do with its practice. Even the use of powers is not confined by law. Thus a leading researcher on water-quality and pollution found that its inspectorate relied not on legal powers to achieve compliance, but substantially on bluff (Hawkins 1984); and the Securities and Investments Board, although having powers since 1988 to ban practitioners from financial markets, took until 1994 to use them, despite a number of plausible cases for such condign punishment arising in the intervening years. Regulation is hence subject to law in the sense that almost all economic and social life is, but regulation as it is practised is largely beyond the reach of law. Certainly the rules of regulation are rarely statutory in the full sense. Even where they are not devised by the regulators themselves, they are not actually legislated but written up according to enabling schedules by ministers and their civil servants, often after consultation with the regulatees. If regulation is to be located, then, we may say that it exists in a political space between law and society, a space inhabited by the state, private interest groups and regulatory agencies, some public, some private, some mixed.

We can identify a number of tendencies of economic regulation, some of them implicit in the above.

1. A tendency for regulation to proliferate to new areas in response to the remorseless search for security and reliability. This does not mean, however, that such regulation is at all powerful, effective, appropriate or reflects a reasonable balance of the various interests of the various parties. On the contrary, there are frequently attempts to introduce weak regulation in order to preempt more stringent versions.
2. A tendency for powerful and well-organised interests to dominate or subvert the regulatory process and to present it in a panglossian way (capture). While this is characteristically and historically represented by the profit-seeking drive of business, capture is not limited in principle to business, particularly as regards individual regulatory agencies.
3. A tendency for markets to be a focus for regulation, particularly because, in a capitalist democracy, rights have been extended but markets remain, and with them their tendency to support the

amassing of power and wealth and its abuse (the social democratic agenda). Markets are hence partially constituted by regulation in order to restrain excesses and failures and to maintain order and respect for all legitimate interests.

4. It has already been noted that, even in the case of state regulation, legislation is usually of an enabling character with detailed rules developed and revised by the regulatory agencies, which are themselves usually at arms' length from the state and staffed and run by those with active interests in the regulated area as well as by representatives of 'the great and the good'. We may hence note a tendency for regulatory practice to be devolved to the periphery, with the state intervening only intermittently when things go persistently and substantially wrong – as they regularly do, both because regulatory regimes are ill thought-out or ineffective and because they become subverted and nullified by powerful interests. Regulation is hence subject to cyclical crises and scandals, followed by formal inquiry and re-regulation.
5. A tendency for there to be a constant struggle between private and public regulation – ordering would perhaps be a better term here. At the practical level this manifests itself in, on the one hand, simple private regulation (clubs) and on the other, in regulatory capture – the subversion of a public regulatory agency by a private club of interests. At the ideological level this appears as the divide between the benign state as the sponsor and guarantor of the regulator, which struggles to achieve effectiveness, order and equity, and the incompetent nanny state, forever interfering and fouling things up and imposing costs, especially in time and opportunity, on private interests, who could sort things out better themselves.
6. A tendency in consequence to an increased concern not just with whether or not to regulate, but with regulatory effectiveness, that is, (a) achieving the reality not just the appearance of regulation and (b) getting the desired results in qualitative terms. The former is usually referred to as compliance and is a problem in its own right. The latter is a lot harder than it looks, not only because regulatory regimes, i.e. the institutions, their rules and their implementation, are often ill thought-out and can produce effects opposite to those intended, but also because the objectives involve the reconciliation of interests the full specification of which only becomes evident once regulatory intervention takes place.
7. There is hence a long-term tendency for the private and closed nature of business to become open to scrutiny, despite constant

resistance, both ideologically and practically. Disclosure is a leading regulatory strategy used to achieve protection of the ever-increasing variety of interests which have become successful in claiming legitimacy – shareholders, workers in respect of health and safety, customers who expect product safety and reliability and investor protection, markets themselves in respect of domination and price and profit exploitation, and so on.

Risk, trust and progress: negotiating regulatory space

Modern industrial societies are hence peculiar social entities. The bases of their solidarity and sense of collective identity have been eroded and at the same time the substantially realistic expectations of their citizens as to security, well-being and improvement in their circumstances are constantly increased by the success of their economies and by the application of science and technology. The notion of technically based progress and the constant improvement of everything, from the efficient working of the economy and of benign and effective government and administration at the collective level, to the remedy of every individual ailment, whether physical or psychological, is now embedded in social and individual consciousness. The problem is that these societies of individuals have few bases for looking to each other for security. Contrast the traditional responses to adversity with those characteristic today. In all societies up to recent times calamity was a constant possibility: death or injury from war or accident, illness both acute and chronic, severe and mild, and affecting oneself, loved ones and economic and politically significant others. Unemployment, poverty and malnutrition were ever-present threats. Although the industrial revolution and its attendant political developments brought substantial advances, it was only in the middle of the twentieth century that a real watershed was reached, after two world wars involving devastating losses and insecurity, with a world-wide depression between them. It was the postwar period that also saw the exponential advance of medicine and the biological sciences.

Constant exposure to adversity and calamity, both personally and among others in the immediate environment, accompanied by economic insecurity and long working hours and working lives, and for women limited control of fertility with its attendant hazards, constituted an environment in which sheer survival and some degree of security – physical, social, financial and emotional – was a major achievement. A degree of solidarity was sustained by the sense that others were subject to the same difficulties and that survival and success required a degree of mutuality, a moral sentiment that survived the encroachments of the market-based competitive individualism that capitalism brought with it.

In the contemporary regulatory society all this is transformed. Adversity cannot be entirely banished, but the establishment of the welfare state was specifically designed to minimise it, to attack in Beveridge's words, 'want, disease, ignorance and squalor'. The welfare state vastly increased the size, power and remit of the state. Its capacities in recent decades have been shown to have been reached or even exceeded – we no longer expect to tax and spend our way to the ideal society. The other instrument of progressive security, however, continues to advance apace, and ever-greater reliance is based upon it: understanding the nature of risks and adversities and hence how to control them, especially through science. By the end of the nineteenth century, the Victorians had acquired a powerful sense of their capacity to dominate the world which had its most tangible expression in manufacturing and in the Empire. Where they experienced satisfaction and optimism, we a century later experience anxiety and at times desperation. We now see the world not as territory to be conquered and problems to be brought under control, but as a biosphere undergoing more and more severe damage at our hands that must be remedied to secure our future. Science, with the backing of governments, is seen as the critical instrument in the absolutely necessary management of the planet and its inhabitants, plant and animal, higher and lower.

We are constantly being made aware of how many potential calamities are the consequence of our own intervention in the pursuit of progress, domination, comfort and security, from deforestation and atmospheric degradation to species-loss and the creation of new diseases and disorders, from asbestosis to genetically manipulated biological weapons and antibiotic-resistant strains of infectious bacteria. At the same time science enables us to identify hazards: sick building syndrome, legionnaires' disease, chronic fatigue syndrome (ME), AIDS, the first cases of which are now thought to have occurred as far back as the 1950s, when the link between cigarette smoke and health risks was being established and no one would have taken seriously the risks of passive smoking.

The creation of levels of security undreamed of in earlier times, together with the capacity of science to discriminate hazards ever more widely and minutely has led to a heightened rather than diminished sensitivity to risk. To put it simply, most of us are aware of how much we have to lose physically, financially and emotionally even if the chances of any major hazard affecting us are remote. The remedy against adversity is hence seen to lie not with others or with God, but with the state and in more research and precautionary measures. Other people are on the contrary quite frequently suspect as the source of the problem, as reckless and maybe drunken car-drivers, negligent and maybe paedophile child-carers, unscrupulous manufacturers and traders supplying dangerous products, ruthless salesmen selling financial 'security' for a fat commission, sexual partners carrying lethal infections. Beck (1990) termed this 'the risk society', but his book was focused principally on the environment. The present analysis focuses on regulation as the counter to risk as an essential basis for sustaining trust in a radically individualised, risk-sensitive society. Regulation is the response to the now instinctive reaction that 'something ought to be done about it' and particularly, in America, that 'somebody ought to be made to pay for the damage caused'. The object of regulation is to calm fears and re-establish trust, and so enable normal social interaction to continue. Regulation constitutes markets by contributing to sustaining the trust that encourages participation in them, a matter to which we will turn below, and it sustains trust in a myriad of other social relationships.

Trust hence exists where there is no awareness of risks – in the gay bath-houses of the 1960s and 1970s – and where the understanding of the risks and their management is good. It is often remarked that were the deaths and injuries from road traffic accidents to derive from any other source they would be regarded as intolerable. The reason for this is that road-users believe, not without foundation, that the roads are tolerably well designed, regulated by the police, that their vehicles are reasonably well-protected in case of accident and crucially that their security lies significantly in their own hands (and feet), their driving skill and prudence. Aircraft travel, by contrast, although much safer and more closely regulated, elicits fears in many because of the passivity of the passenger, strapped into the collective aluminium coffin in a state of more or less suspended animation for the duration of the flight.

It follows that when there is a shift in awareness of risks, the 'regulatory space' in Hancher and Moran's phrase (1989) has to be renegotiated, the interests of the various parties dealt with (which does not necessarily mean accommodated) and a new basis for trust and stability established. Very often these renegotiations are minor: an industrial accident shows that a process has a hazard that had not been identified and new precautionary procedures are developed; sometimes the reverse will take place and a more effective technique for dealing with a known hazard may be invented. Sometimes awareness of risks may take root in the public and require a careful response, as with the wider recognition of brain-damage in a very small proportion of routine vaccinations against childhood diseases. This is the product of time in two senses: first the experience of two or three generations of vaccinated children has produced the evidence of brain-damage and enabled the link to be demonstrated – the sample size is large enough even with very low incidences. Secondly, the security of two or three generations of parents whose children are not dying and being disabled by childhood diseases has transformed vaccination from a blessed relief to a taken-for-granted reality, automatic elimination of risks. Hence the very small risk of vaccine damage looms much larger. It then becomes important for the public to be made aware of the certainty that epidemics of childhood diseases would recur with fatal consequences if rejection of vaccination were to become widespread.

Where the basis of trust is significantly compromised, however, it can be very much harder to re-establish, because the renegotiation necessary to achieve this exposes the pervasive role of ideology. Ideology has the corrosive effect upon trust that acid does upon unprotected skin. It is hence best kept in its cloaked rather than its arrant and militant form, since when it is overt it will brook no opposition and claims a monopoly of the truth, so preventing regulation from becoming effective, that is, achieving the best it can in the light of the risks.

Trust, risk and ideology: the deregulation charade

It is one of the many paradoxes of the success of capitalism that it owes its very survival to regulatory and state intervention and yet it continues to rail at it as an unjustified burden and interference in the sacred freedom of the market. The fundamental ideological divide in respect of regulation is thus that the free market protagonists, led in recent years by the Chicago school of economics and politically by the Reagan and Thatcher administrations, see regulation as undesirable not simply as a cost burden on business, but as a restraint upon free trade: the market will in the end drive out the bad and sustain the best. This applies to all spheres of life, not just markets in the financial and economic sense, though there are more and less radical views. At the other extreme lies the interventionist social democrat. State socialism (that is, the comprehensive control of everything by the state for the benefit of all, including for practical purposes the reformist socialist alternative of nationalisation of parts only of the economy), having failed, the militant social democrat sees himself as the president of Liliputia taming the giant Gulliver with the threads of regulation. His power derives from the tendency to panic and the sense of technical ignorance and powerlessness of his subjects, who demand that 'something be done about it', whatever 'it' happens to be at the time: dangerous dogs, paedophiles released after serving their sentence, hand-guns, vitamin B6, not to mention those timeless favourites 'sex, drugs and rock'n roll'.

It should not surprise the reader to learn that the writer places himself on the left-hand-side of this divide and regards regulation as essential and potentially beneficial. The crucial question, to which later chapters are devoted, is making it work effectively, which is by no means easy. It is certainly the case that regulation restrains and restricts, and that it imposes costs. It also may not work in achieving its objective, either because it is badly designed or because it is effectively resisted, or both. Getting regulation right, however, does not turn it into a merely technical matter: it may be made to appear technical, but ideology is everywhere, in every rule, every practice, every policy as well as, usually rather more obviously, every debate. It is there because regulatory space is contested and the interests of the various parties have to be fought out and an accommodation reached. Only when it is can trust become established, and any deviation from the accommodation will reopen distrust and restart campaigning. This book could, therefore, have been written to expose the pervasiveness of ideology; but instead the author's concern is with effectiveness, both because effective regulation is desirable in itself and because effective regulation conduces to acceptance of regulation as beneficial, the point being that it is not all and any regulation that is beneficial.

The above remarks are necessary not simply for the sake of clarity but because we have just emerged from a period of extreme ideological commitment to right-wing market ideology which has been militantly opposed to regulation. Both the Thatcher and Reagan administrations consciously attacked what they saw as highly damaging cumulative regulatory restraints going back in the United States at least to the New Deal but markedly increased by the environmental measures of the 1970s. The number of pages in the Federal Register devoted annually to rules and regulations tripled between 1970 and 1975 to 60 000 (Sigler and Murphy 1988, p. 41). In the UK, the postwar consensus on the welfare state and full employment was Thatcher's immediate target. She was, however, also committed to easing the burden of regulation and equally failed to achieve as much as she would have liked. In Britain, the highly successful (at least in political terms) denationalisation programme necessitated the creation of regulatory agencies for the utilities, the like of which had long existed in the US and, in doing so, the competing interests of government, consumers and the businesses were inevitably brought out into the open, where in the past they had been managed, largely behind closed doors, by the state. Worse, it now became necessary to create competition where none existed, and the lot of the new regulators was frequently to simulate competition in conditions of actual private monopoly. This is a matter to which we will return in the next chapter. Suffice it to say at this point that it demonstrated that for a number of industries competition and free markets were not the natural state of affairs, but had to be created and maintained by regulation. Similarly, the financial sector in Britain, hitherto largely run on the basis of informal and often private regulation, where there was any at all, had to be subjected to state supervision and more formally as the price of ensuring modernisation, foreign access and continued success in the international marketplace (Clarke 1986).

Reagan made greater inroads into regulation than Thatcher, both in the formal sense of reducing the number of rules and in the informal and much more significant sense of relaxing the pressures to conform. As Sigler and Murphy put it, 'deregulation is more a mood or an attitude than it is a specific policy. The invitation to non-compliance inherent in the stance of deregulation has not been misread by the managers of many businesses' (p. 43). In Britain, the phrase was 'regulation with a light touch'. Even in those countries where the new right achieved substantial political ascendancy, however – and it is important to remember that it was almost complete in the case of Thatcher and Reagan, with the traditional liberal left in total disarray and new-right policies being adopted world-wide, including the socialist governments of France and Spain – there were misfortunes (Three Mile Island did not redound to the credit of the nuclear industry in America), and eventually there was opposition. Reagan's attack on the Environmental Protection Agency, a 1970s demon, foundered on the successes of his nominee in reducing the enforcement budget by 45 per cent, with the result that Congress gave her more money than requested and responded to reports of staff demoralisation by initiating an enquiry. Reagan was forced to back down and replace her.

Just as much that is associated with the 1960s did not take place until the 1970s – notably the Women's and Gay Rights Movements – so the deregulation of the 1980s continued into the mid-1990s, thanks to the election of Bush and Major as heirs to Reagan and Thatcher. As is so often the case in politics, what begins as zealous innovation becomes ossified as a bureaucratic institution. In respect of deregulation, this involved setting up procedures to evaluate every proposed new rule, to establish whether it is needed. Reagan neatly exploited the capacity of the powerful EPA to require an environmental impact analysis of proposed projects by insisting that all regulation go through a regulatory impact analysis. In doing so, however, he at least laid the foundations for undertaking a substantial appraisal and his 1981 order required an account of the costs and benefits of the proposed regulations and their distribution, together with an account of alternative means of achieving the same ends and why they would not work as well as those proposed. Although Reagan was concerned to minimise new regulation, his review at least included the questions of effectiveness and proportionality. Clinton superseded Reagan's order with his own in 1993, but he did not change it significantly, other than by disclosing more of the process to the public to deal with accusations of potential capture by private interests. The British initiative, explicitly inspired by America, was much more overtly ideological. There was no commitment to proper cost–benefit analysis, but rather a simple concern to minimise costs and to ensure harmonisation with other regulation, hence the term Compliance Cost Assessment. The deregulation unit, housed in the Cabinet office, subsequently became part of the fiefdom of the Deputy Prime Minister Michael Heseltine, who was keen to show that he was reducing the burden of regulatory costs on business, especially smaller business. The unit's logo was a pair of scissors cutting red tape.

There is no doubt, first, that ill-conceived regulation may be ineffective (and hence whatever costs it imposes achieve no benefits); secondly, that it may be conceived or implemented in such a way as to antagonise those subjected to it, in which case it may not succeed even though appropriate; and thirdly, that all regulation imposes some costs. As Froud and Ogus's (1996) detailed review of the CCA documents shows, however, it was unlikely to engage effectively with any of these problems.

> Since CCA is not accompanied by any sophisticated conceptualisation of what determines business competitiveness or normal business growth, it is not easy to ascertain how CCA is contributing to overall constraints. If the objective of CCA is represented more

> broadly, as that of creating a favourable regulatory environment for business, its success could be judged on the basis of the lower overall costs of compliance, compared with those which would be incurred in the absence of the instrument. Such a goal could be achieved in two ways: fewer new regulations introduced, or regulations introduced in a form which allowed compliance with the law at a lower cost. Even this formulation, however, requires the identification of the substantive impact of the technique; its impact must be isolated from the regulatory outcomes which would have arisen in its absence. This policy counterfactual is difficult to measure (p. 15).

The authors conclude that the purpose of CCA may be more ideological than practical.

> As yet there is little concrete evidence that the substantial costs imposed on both government departments and business in providing CCAs have been matched by the actual savings in regulatory compliance costs, but the fact that CCA has survived in the UK implies that it is meeting some objectives. It may be a relatively low cost method of demonstrating to business that its interests are being considered (p. 16),

but not necessarily accommodated.

> If it is not clear what role is being played by CCA, or in particular the information supplied by business to officials who produced them, then the regulatory system becomes unaccountable in a more general sense. Far from CCA controlling their behaviour, officials may in some cases find them to be a device which allows them to legitimate their own preferences for new or particular forms of regulation taking advantage of the … technical ambiguities in relation to estimating compliance costs (p. 17).

Thus ideology thrives everywhere, not just at the ground level, but also that of sectional interests, in this case those of the civil service, whose powers Thatcher devoted some energy to attempt to restrain, attempts joyfully lampooned in the TV series *Yes Minister.*

The deregulation unit was hence not surprisingly transformed by the Blair administration, with its predominantly pro-regulation bent, but cautious as to the issues of costly, ineffective, premature or overzealous regulation. It was renamed the Better Regulation Task Force, which pronounced itself committed to the unexceptional objectives of transparency, accountability, targeting, consistency and proportionality. Rather than a standardised evaluation process it identified issues for review, so avoiding the issues of cost–benefit analysis in formal terms. Since all but the last of the objectives are bland, the risk both of failing to meet them and of creating severe restraints and blockages were likely to be minimal, and in the meantime particular areas of concern could be addressed with due deliberation.

Just how problematic even this cautious procedure could be was rapidly demonstrated. One of the unit's first reviews was of child care. It concluded that, while state oversight of nurseries, pre-schools and commercial childminders should remain subject to state inspection, informal care (nannies and au pairs) should not.

> Whatever method parents use for recruiting nannies and au pairs, we believe that parental responsibility is the key to ensuring children are protected. The government role should be limited to providing parents with clear information on the steps that they should take when employing a nanny or an au pair. (1998, p. 16)

Besides, the report said, the numbers were too great and the turnover too rapid. It was a question of risk and proportionality, said the Prime Minister. The government should not take responsibility for all risks. This was seen as a significant move, coming in the wake of calls for an official register to remedy the false sense of security to which the emergence of unofficial registers had given rise (*The Times*, 2 September 1997). Only two weeks later, a registered childminder was convicted of the murder of a child in her care. By not disclosing her previous marriage she had avoided the discovery of her career as a prostitute. Three children from this marriage were taken into care.

The Minister responded with a suitably cautious statement about keeping the matter under review. Even though the case did not involve a nanny, it was likely to concentrate minds on the issues of risk and proportionality and the political acumen required to get the public to accept responsibility for some risks. This episode, however, was small beer compared to the regulatory disaster which dogged the Major administration and had repercussions world-wide.

BSE: confusion worse confounded

It may well have been with a degree of smugness that the incoming Labour government in 1997 established an independent enquiry into the BSE fiasco, whose handling it had repeatedly criticised in opposition. As the evidence unfolded it was plain that there were lessons for any government in the difficulty of identifying a new disease, of coordinating expertise from different areas of science, in different physical locations, and in reacting appropriately in achieving a balance between protecting the public and not being unnecessarily alarmist and so damaging the beef industry. What transformed the affair from a series of failings arising out of these factors into a disaster which had its origins in the earliest years of the Thatcher administration and was not resolved by the time Major left office 18 years later, was ideological commitment.

Spongiform encephalopathy was long known in a variety of animals. It is manifested as the well-known disease of scrapie in sheep, but despite the known exposure of many people to it for over a hundred years it was not known to infect humans. The human analogue, Creutzfeld Jacob's Disease (CJD), was well-known by the 1990s. It affects about one person in a million, with a long incubation period – perhaps 25 years – and an average age of onset of 63. It is untreatable and fatal. The dangers of artificial spread were known by specialist researchers. One warned the government in 1976 of the risks of CJD spread via the use of human growth hormone taken from cadavers. It was also known by a few scientists that scrapie could jump species. In the 1960s mink were infected with scrapie by eating raw mince.

The source of the BSE epidemic, however, was firmly rooted in the drive for profit and a desire for deregulation. The Thatcher administration rejected proposed regulations on the processing of meat and bone-meal for cattle-feed. A combination of steam and solvents had traditionally been used to extract the tallow from carcases, which probably killed the infective agent. These were reduced under the new regulations. By this time it had long been accepted practice to feed ruminants animal protein, since this could be produced cheaply from unwanted carcases and was efficient in promoting growth because of the protein content. The dangers of feeding ruminants on animal products was not seriously contemplated. The entire agricultural sector had by the end of the 1970s become dependent upon regular and often substantial subsidies under the EU Common Agricultural Policy and on constant government advice and exhortation to improve yields and production methods. The animal feed industry had grown substantially as a result of the success of intensively reared pigs, chickens and, especially for the winter months, cattle.

It is hence unfair to lay blame entirely at the door of the Thatcher administration, although it bears adding that the Tory party traditionally represents the shire counties and a significant minority of its MPs come from land-owning and farming backgrounds. A critical factor in the chain of delays and failures was the powerful background support for the profit of the agricultural industry and a militant commitment to minimise the burden of regulation.

The first of the infected feed went to cattle in the winter of 1981–82 and the first cases of BSE were identified by a Hampshire vet in 1984. After ten deaths, samples were sent to the government's Central Veterinary Laboratory (CVL), where the duty pathologist noticed similarities with scrapie. These findings were ignored, however, on the grounds that the herd had other disease problems, and the CVL published a paper on the 'first' cases found in Kent in 1985. In late 1986 the CVL confirmed 'scrapie in cows' as a new disease, BSE, but it was not until May 1987 that the head of epidemiology was told. He informed the junior agriculture minister (a former farmer and butcher) in the midst of the June election campaign. The reaction of the Ministry of Agriculture (MAFF) was concern that 'ill-informed publicity could lead to hysterical demands for immediate draconian government measures. This in turn could alarm other countries and lead them to prohibit imports of cattle, semen and embryos from this country.' There was 'no evidence that it is transmissible to humans'. Hence 'it would be inappropriate and premature to consider imposing restrictions in the herds where affected cattle had been identified', and the best approach was to admit that the disease existed and to commit the government to a thorough investigation. (*The Times*, 2 June 1998)

The ministry's caution is understandable, even though with hindsight wrong in every particular. BSE did prove transmissible to humans, albeit to an extent which may yet prove minimal. Failure to take decisive action, however, eventually prompted just the reaction abroad which was feared, with the EU imposing a world-wide ban on British beef. In the meantime, the director of the neuropathogenesis unit in Edinburgh learned of the problems. The unit had probably the greatest length of experience with scrapie and had a clear concentration of relevant expertise, yet such was the frustration of its director with lack of access to the CVL's data and research findings that he retired two years early. By the end of 1987, however, the CVL had reached its own conclusion on the origin of BSE in infected feed and in 1988 the government's chief medical officer approached the distinguished scientist Sir Richard Southwood to chair an advisory committee. At its first meeting in June the committee heard that the heads of infected cattle were hacked off with a chain saw and the carcase passed on into the food chain. This was stopped and the use of meat and bone-meal in feed banned. The status of a slaughter policy to eliminate BSE from the national herd was compromised, however, by the reluctance of the government to fund compensation and by the refusal of the National Farmer's Union to accept slaughter without full compensation. As the permanent secretary of MAFF put it to the enquiry: 'Two of the main features of government policy in the second half of the 1980s, were the desire to reduce public expenditure and the belief that the agriculture and food industries ought to bear more of the costs of research and advisory work' (*Times Higher Education Supplement*, 14 July 1978, p. 15). A slaughter policy of ever-increasing dimensions nonetheless ensued, forced upon the government by the accumulating evidence and by the mounting resistance in Europe. By 1998 the total bill, including subsidies from Brussels, was £2.5 billion and was likely to rise by £1 billion in the following two years, according to the National Audit Office.

In early 1989 the government appointed another independent advisory committee on BSE, which reported in four months and was dismayed that its report was not published until the following year. It seems likely that the cost and negative publicity associated with the problem contributed to the delay. In 1990 the spongiform encephalopathy advisory committee, under a different but still independent chairman, became established as permanent and as the main source of independent advice to the government. The government's own Central Veterinary Laboratory still had an important role, however, and produced estimates of the number of cattle likely to be infected. Its figure of 200 000 was rapidly overtaken, but efforts by another distinguished academic epidemiologist at Oxford to get access to the database failed. Professor Anderson continued his efforts, but it was only in 1996 that he was finally allowed to analyse the data. When he did so he was able to show not only that the number of cattle infected was around one million, but that the ban on meat and bone-meal in feed had been widely flouted and that this had contributed significantly to the numbers.

The problem of the effectiveness of the ban on contaminated feed was not one that was simply ignored during this period. On the contrary, it was deliberately suppressed. Yet another independent committee was convened specifically to advise on the monitoring of the feed ban. The minister accepted its advice in mid-1992 that a permanent committee was needed to police the ban, which was not being properly observed. After a Cabinet reshuffle, however, the decision was reversed and the incoming minister wrote to a colleague: 'The main thing that worries me is that if we set up the proposed committee, it is almost bound to recommend tightening regulations or other forms of controls.' By mid-1993 inaction had turned to decisive rejection and the head of MAFF's food policy group circulated a memo stating that 'a committee of the kind proposed is almost bound to recommend at some stage changes in regulations or the way in which the feeding stuff industry operates. To set up the committee would, therefore, add to the pressure for regulation when we are trying to go the other way' (*The Times*, 21 March 1998).

The result was that by 1995 the *British Medical Journal* published an article claiming that 1.8 million cattle were infected and that 30 million people had probably eaten infected meat, even if not the most infectious parts of the animals. In September, the first of the new variant CJD cases were diagnosed in Edinburgh, at a hospital which had set up a specialist unit to monitor CJD in 1990 on its own initiative. By 1996 ten cases had been identified with their characteristics distinguishing them from CJD: the age of sufferers was much younger – 18–41; and their psychological symptoms were chronic anxiety and depression rather than forgetfulness and odd behaviour; and in the clinical damage to the brain the threads left by the spongiform damage were bundled together in clumps. The minister (different once again) was again asked to set up a permanent feed-monitoring committee and again refused, though controls on feed and on slaughter and disposal were increased. Together these did finally offer the prospect of eliminating BSE, though major uncertainties remained.

One of the these was the size of the new variant CJD epidemic. By 1998 only 27 had been identified, far lower than earlier estimates had considered possible. With a lengthy incubation period it could be some time before there would be any real evidence about the extent of human infection. The best that could be said is that if the British population largely escaped it was more by luck than by judgement. Another area of uncertainty lay with sheep. If scrapie could modify and pass to cattle, could the modified form of BSE be passed back to sheep? Sheep are less likely to be fed concentrates, but over-wintering is a problem that requires supplementary feeding in some areas. The difficulty is that there is no test for BSE in sheep that will discriminate between it and scrapie. Until it is confirmed that sheep are BSE-free, reliance cannot be placed entirely on the removal of the brains, spinal cord and spleen from the food chain, the precautionary measure that was put in place.

Nor could a government with strong anti-regulatory sentiments have derived any satisfaction from the price paid in additional regulation for the lifting of the EU ban on international trade. Every animal is required to be identified from birth and its history logged throughout its life, including all transfers of ownership, with everything recorded on a central computer, much in the manner of a motor vehicle. The burden on farmers completing the necessary documentation is considerable, and there is likely to be a cost to them and to the state. Northern Ireland, where such a scheme had already been developed to combat cattle-smuggling back and forth across the border with the south, in order to claim EU subsidies, and where cattle are largely able to be grass-fed, in 1998 became the first region in Britain to have the trade-ban lifted.

BSE, together with the outbreaks of a nasty new variety of food-poisoning, E-coli 0157, which killed a number of people in several areas, notably Scotland, in 1997, provided the impetus and the opportunity for a new government to take radical action. Besides the problems of anti-regulatory sentiment and the dispersal and lack of co-ordination of relevant expertise, and the notorious tendency to secrecy and caution of the British state which lay behind the BSE débâcle, the government needed to address the position of the ministry (MAFF) and its close alliance with the farming and feedstuffs industries. It was only too plain that the interests of consumers of food were not the same as those of the producers. The Food Standards Agency which was proposed was the brainchild of a respected and energetic academic nutritionist currently heading a WHO working party on obesity, and chairman since 1990 of the National Food Alliance, an umbrella body of food and health consumer groups. He successfully lobbied for both food-safety and nutrition to be included in the agency's remit and for it to be answerable to the Department of Health, not the MAFF. The White Paper, however, proposed an operating budget of £100 million, funded largely by the food industry and that 90 per cent of the staffing should come from former members of MAFF. Professor Jones saw merit in the funding arrangements as giving the agency freedom from government budget-squeezes, and foresaw a better national coordination of public and environmental health and improved awareness of food safety. Others expressed fears that the food industry would exercise undue influence and that the ties with MAFF had not been fully cut (*THES*, 14 July 1998). Time will tell whether the agency is the radical success that is required. Certainly public expectations were heightened and attention is now tightly focused as regards food safety.

The debate about the FSA, however, serves to remind us that ideology is not concerned merely with ideas, but with ideas as the expression of material interests. Those interests usually have a legitimate role in regulation and often include a concentration of expertise that it is indispensable to tap. The difficulty is to allow interests legitimate expression and participation in regulation without becoming beholden to them or converted uncritically to their way of thinking, and to remain critical, independent, well-informed and capable of reaching the right judgements and insisting on them. That, as we shall see, is a demanding task that is frequently not achieved.

2

Private Regulation: from the Acceptable to the Unacceptable Face of Capitalism

Given the huge size and responsibilities of the state in a modern industrialised democracy, it is natural to associate regulation with state regulation. While it plays a very large role in regulation, as later chapters will show, it is a mistake to identify regulation wholly with the state, however. Private regulation, particularly by business, predates state intervention and continues on a very substantial scale in the midst of state regulation. Nor is it the case that markets are naturally competitive and self-ordering. On the contrary, as one economic commentator put it, 'creating the conditions of trust in which private citizens can operate has always been the main function of the state – one that long preceded the macro economic and redistributive agendas of the twentieth century'. (A Kaletsky, *The Times*, 26 March 1996.) To put the matter more widely, businesses and markets may be analysed by economists in formalised abstract terms of rational calculation and exchange but they exist in and are sustained by societies. Further, it is, to say the least, questionable whether they have 'natural' features such as the pursuit of profit, free competition and market clearing equilibrium prices.

Indeed, as soon as one begins to think of business and markets as involving real people, one is presented with a diversity of aspirations, obligations, moral precepts and chains of reasoning. Behind this individual and group diversity lies a society which is forced to accept at a collective level the need to keep the economic show on the road: to sustain trust, prevent abuses and prevent markets breaking down, in order that its members' material and other social needs and aspirations are tolerably well served.

The prevailing wisdom ever since the rise of capitalism has been that the maintenance of free markets is the best basic model for achieving this, but that free markets may often need to be restrained and modified to accommodate other social objectives. Further, business does not in practice operate or seek to operate according to free-market principles. Despite lip-service paid, especially by representatives of larger businesses, to the virtues of competition, it is not a discipline that all but a few businesses willingly accept. On the contrary, they seek constantly to avoid it in the pursuit of a much more attractive goal, security. Thus, if one takes the corner shop or the giant corporation one does not see a gutsy embrace of competition and a constant striving for better products and services at keener prices but an attempt to secure control of a patch of business. The corner shop cultivates its customers, acts as a location for gossip and news, provides a noticeboard for events, sales and exchanges, perhaps casual employment for local youngsters, delivery services for the elderly and the housebound, informal credit to longstanding customers, a location for getting up local petitions. It will not seek to expand beyond a certain point because to do so would be to enter a new location and spread the capacities of the owner too thinly. Of course, the occasional local shop-owner will expand and diversify – most of the major supermarket chains can point to these origins – but they are exceptions.

Similarly, big business was long ago recognised by Galbraith (1958, 1969) and others to seek not so much constant expansion as stability and security. For the bigger the business, the easier the collapse. IBM's now legendary failure to recognise the significance of the personal computer market seriously affected the computer giant, which had concentrated its efforts and expertise on mainframes. In markets where competition is the principal driving force, instability can be extreme, as was illustrated by Gerald Ratner, who joked that the reason his very successful chain of down-market jewellers were able to market items so cheaply was because they were 'crap'. That one remark, widely reported, cost Ratner his business, which was eventually sold and the name changed. Big-business attempts to achieve security by advertising and building a positive image with the public, by the exploitation of patents and by branding is sometimes extremely successful – vacuum cleaners are sometimes referred to as Hoovers, rather than by the name of any rival company; few would understand what yeast extract is, but the word Marmite is instantly recognisable. Further tactics may be less savoury – buying out rising, small and innovative competitors, or using financial muscle to compete on price for long enough to force capitulation; buying up sources of supply and distribution; taking over or merging with major rivals; coming to agreements on how to manage the market to everyone's benefit.

The point is, then, not that free market competition is unimportant, but that it is by no means the only or even the main game in town. Most businesses have more modest aspirations than zapping the competition and becoming world-beaters; those that are world-beaters devote much of their energy to making sure they stay that way. It is because of this private ordering that the state is called in to intervene to safeguard the public interest.

There is an additional reason why this has become necessary. As capitalism has developed, it has become increasingly technically sophisticated. One implication of this has been that the costs of setting up in business, in industry after industry, have risen way beyond the limits of the would-be entrepreneur. It is instructive to inspect the foundries of Abraham Darby and his descendants in Coalbrookdale in the Severn Valley in England, which date back to the seventeenth century. The first ones are so small that they could be accommodated in the average backyard. Within a few generations they had grown greatly, but all are dwarfed by the giant steelworks of today. More recently cars are associated with innovative individuals, who gave their name to companies, mostly long since amalgamated with others. What began as the work of coachbuilders and mechanics is now the preserve of a few international giants. Significantly it is not merely the cost of designing and manufacturing vehicles that is critical, but a capacity to achieve huge economies of scale and customer loyalty by marketing world-wide. We have hence reached the position where many industries are dominated by a few, usually multi-national, corporate giants, who have the interest, experience and motivation required to control their markets and so secure their position and profitability. Further, the state is now responsible for so many services that it is a major purchaser, whether at local or national level. This is universally the case for military equipment and varies in its terms and extent for such other areas as education – schools and college buildings and equipment – health, including hospitals, drugs and equipment, and housing, roads, sewerage, railways and civil aircraft, for example.

The consequence is that the relationship between the state and business is not one of arm's-length intervention, of ringmaster, or of occasional and limited regulation, but of constant, active, detailed negotiation. On the positive side, the state seeks to promote the economic health of each industry and on the negative to control what are perceived to be abuses: environmental damage, risk to employees and the public, exploitative pricing, oppression of competitors, exploitation of the state itself, a notorious risk in defence contracts with their substantial premium on technical innovation which is difficult to evaluate and to cost. In these circumstances it is frequently easier for the state to deal with an industry that is organised into a representative body, an industry association. When this happens successfully agreements can be reached semi-formally and informally, which are effective throughout an industry without the need for formal regulation. This arrangement is often referred to as corporatism. It allows the industry to present its benign face as reasonable, responsible and cooperative while often being able to negotiate in private to secure what it considers its vital interests. The role of industry associations, often in collaboration with the state, is hence the first topic of this chapter.

As was identified above, a more substantial form of private regulation by business involves the management of markets and in particular the consequences of competition. This can take two broad forms which in practice may be closely related: the avoidance of competition through price-fixing or market-sharing cartels, and the dominance of markets by one or a few firms even where there is no complete monopoly. The outcome is state intervention to prevent oppression of smaller players and abuse of the public, and the assumption in the Anglo-Saxon world is that all, or almost all, manifestations of this type of private market management are against the public interest. As we shall see, that is not a view shared by all industrialised countries. Nor are cartels and other market management arrangements by any means always without advantages to the public.

A final area in which regulation, both public and private, has been highly problematic at times is related to the issue of industrial concentration and market dominance, but is distinct from it: mergers and acquisitions. One aspect of industrial concentration is the takeover of firms, usually by larger ones. Because this may reduce competition, many industrialised societies have rules which are intended to restrain it, but as we shall see they are often not enforced or not effective. Even more problematic are the takeover booms that build up at times, which at their height can coerce large numbers of businesses of significant size into choosing whether to be a predator in the takeover market, or a victim. Despite excesses, which in the 1980s became grotesque, attempts at restraint have been limited in the Anglo-Saxon world, though continental Europe and Japan are much less prone to them.

Private regulation cannot be entirely accounted for in the scope of this chapter and the next, which deals with the special case of the professions. It is diverse and pervasive and not only precedes but always accompanies state regulation, as we shall see in later chapters. To cite but one example, insurers have played a role in requiring businesses to improve their standards of fire safety and physical security, and in some instances put pressure on industries to improve the fire-safety of their processes in the interests of minimising payouts for fire-damage and hence also controlling premiums for fire-coverage (Birbeck 1998, p. 82).

Private regulation in futures markets

Before going on to the major topics of this chapter, therefore, it is worth pausing to review an interesting example of private regulation surviving and indeed proving more effective than state regulation in markets that are often at risk of abuse. Most people would correctly see futures markets as places where the unwary risk losing their shirts. It was in the Singapore futures market that one reckless trader brought one of the longest-established British merchant banks (Barings) to destruction (Fay 1996). As Gunningham's (1991) comparative study of the regulation of the markets in Chicago, Hong Kong and Sydney shows, things can go very seriously wrong. In the 1987 stock market crash, the Hong Kong market closed and many people lost a great deal of money. Chicago exchanges were also subject to serious abuses in the 1980s, resulting in several formal enquiries and attempts at more effective regulation. The Sydney exchange, however, has been substantially trouble-free. The differences, Gunningham shows, are largely accounted for by differences not in external and formal, but internal and often informal control and also by structural factors.

The risks in futures trading derive largely from the use of open outcry in a trading pit to cope with a market which is very volatile. Brokers meet in this trading area face to face, and communicate their interest in buying or selling, and the volume and price, by voice and by gestures. The contracts which are made are for the right to purchase a commodity – flour, coffee, beans – in the future at a particular price. Originally, futures markets developed to allow those with an interest in owning large stocks of particular commodities to try to avoid (hedge against) volatile prices. Similar markets developed in currencies and then in interest rates and stock market indexes for the same reasons, but in each case the markets took off as trading arenas in their own right and, just because of their volatility, were subject to speculation. This increased volatility, which now derives from multiple sources. Coffee futures will be affected by reports of frost damage in Latin America, for example, but also by the number of traders wanting to buy or sell in the expectation of a profit, and by the immediate impact of a large order to buy or sell. Prices in consequence change from hour to hour and often from minute to minute. Trust is essential between brokers on the pit floor. As one trader put it:

> the entire industry works on the honour system. Every trader who steps into the pit is bound only by his honour to live up to every trade he makes. Millions of dollars change hands daily by this method. Nothing is signed; there is not even a handshake. Sometimes there is not even a verbal exchange, merely a wave of the hand or a nod of the head. Any trader can cheat any other trader any time he chooses.
>
> (Gunningham 1991, p. 310)

The incentives to cheat are considerable if, as it is very easy to do, a broker misreads the movement of the market and stands to make a loss.

How is cheating then prevented? As we have noted, this is more successful in some markets than others. Gunningham's conclusions can be broadly summarised in terms of four factors. First, a market with large firms – banks and other large financial institutions – participating in it is at much less risk than one dominated by small firms and private individuals. Large institutions can hold the threat of withdrawing business from a broker as a lever to ensure honesty. As large repeat players they will also be able to monitor a broker's track-record in comparison with others they may also use, and they will have personnel with skills and experience in futures markets scrutinising trades. Private investors will have none of these protections and as a result are open to abuses, many of which they may never become aware of. The Hong Kong Stock Exchange was dominated by private investors who accounted for 85 per cent of business; abuse was rife. Sydney, by contrast, was dominated by the large institutions; private investors were not banned, but were not encouraged, in order to minimise the risk of abuses. The role of large firms in the formal management and regulation of the markets was also critical. Gunningham notes that in such cases one category of market participants dominated formal representation on the exchange's governing body and was also able to exercise influence with external state regulatory agencies in respect of the formulation and application of detailed trading rules. In the case of Hong Kong, the dominant group was small local Chinese traders who explicitly wished to prevent domination by the large, mainly British, financial firms which had long had a key place in Hong Kong's economy. In Chicago, representation was dominated by individual floor-members trading on their own account and independent floor-brokers, who blocked reforms that might have reduced the scope for abuses. In Sydney representation was dominated by the financial institutions, who both wanted to minimise abuses in their own interests and wanted to promote the exchange internationally as a 'clean' market, already the largest outside the USA and the UK. Without begging the question of the capacity of private interests to dominate or capture state regulators, which will be addressed in a later chapter, it is evident first that, in almost all regulation, private interests and especially those of the regulated, will inevitably play a significant part; and, secondly, that some markets may be organised so that this influence may be more significant than others. As the differences between Sydney and Chicago illustrate, these features may be hard to change but they are not 'natural' or 'immutable'.

The second factor affecting the level of abuse and indeed order in futures markets is the size of the pit. The system based on face-to-face interaction and open outcry is plainly impossible when numbers go beyond a certain point. Sydney, with 40–80 traders operating in the pit, was within these limits, with the result that the informal system of trust and sanctions could be readily sustained. Chicago with 200–500 traders on the floor at any one time, was chaotic. As one trader said: 'You can't see the stuff that's being traded five feet in front of you ... all you're worried about is being poked in the eye' (1991, p. 311). At times four or five separate prices prevailed at different points in the pit. Crowding also made formal surveillance with cameras, microphones and inspectors all but impossible.

Thirdly, the use of employed rather than independent traders clearly reduced the likelihood of abuse, though it is no panacea: Nick Leeson, the architect of Barings' downfall, was an employee of the bank, though it should be said that it was precisely the degree of independence that the bank effectively accorded him in the use of its funds that allowed matters to go as far as they did (Fay 1996). In Sydney, the exchange was dominated by salaried traders who did not have to bear losses personally, whereas the independent brokers who prevailed in Chicago effectively froze out salaried traders in order to preserve their control of the pit. It was remarked of the open-outcry system that it is only too easy not to make eye-contact with a trader you wish to avoid. The pressures to abuse in Sydney were also mitigated by the use of a continuous clearing system which registered trades during the day whereas, in Chicago, clearing of trades only took place at the end of the day, when prices might have moved significantly. This became particularly important in respect of 'outtrades', where there was confusion about the transaction and where there is a clear rule that the broker not the customer is liable for any losses. Brokers responded by cheating customers in order to recoup losses.

Finally, an increase in competitive pressure conduced to increased abuse in Chicago. Up to the latter 1970s markets were cushioned by fixed and minimum commission-rates and other restrictive practices, including restraints on international competition. Thereafter, these restrictions were progressively dismantled as a result of the globalisation of trading, in turn made possible by modern high-speed telecommunications and by the drive for deregulation. Commission rates dropped to one-third of their earlier levels and competition for business greatly increased. This led to greater risk-taking, increased risks of insolvency and downward pressure on traders' income, as well as to cheap trading costs to customers. The outcome was a far more widespread resort to cheating, which came to be seen as necessary and quasi-legitimate.

A number of general points thus arise out of Gunningham's study. Markets are not natural entities. They are socially organised, they can be changed and they reflect national cultures and circumstances. Private arrangements which may be 'in restraint of trade' may have their advantages in securing public as well as private interests, as we shall see in this chapter. Deregulation, discussed in the last chapter, may have had the benefit of leading to reappraisal and re-regulation in the longer term, but in the short and medium term it led far too often to increased opportunities and pressures to abuse. Effective regulation hence has much to do not just with regulation itself, or the zeal with which it is administered, but with the way in which businesses and markets are organised and operate. And private regulation not only co-exists with state regulation but may at times be more effective if it is properly caried out.

Industry associations and corporatism

The role of industry associations is often reminiscent of Hilaire Belloc's cautionary verse about Jim, who ran away from his nurse and was eaten by a lion, the moral being 'always keep a hold of nurse for fear of finding something worse'. That something (the lion) is the state, which is often seen as intervening in a potentially burdensome, and of course ill-informed, way. Hence industries form self-help groups (industry associations) and attempt to draw up codes of conduct, with the sanction of expulsion from the association for violations. The difficulty with this is that industry associations are entirely voluntary and in constant danger of being seen to be ineffective either because they do not represent the great majority of firms in the sector – there are too many outlaws – or because, like a convoy, they sail at the pace of the slowest member and hence do not respond sufficiently to complaints about industry misconduct.

Such were the difficulties of the British Council of Mortgage Lenders (CML) in the 1990s. The Council was formed in parallel to the Building Societies Association, who dominated the domestic mortgage market until the 1980s. The property boom in the 1980s, which reached unparalleled heights, attracted substantial numbers of new lenders into the market, including foreign banks and renewed interest in domestic mortgages by established British banks. In addition, deregulatory legislation in 1986 allowed banks and building societies (the equivalents of American Savings and Loans institutions) to diversify and compete more directly with banks and, if they wished, to terminate their mutual status and convert into banks. With smaller building societies also being taken over by agreement by larger ones, the balance in the lending market shifted progressively to the non-building-society lenders. The building societies had their origins in nineteenth-century concerns with thrift and mutuality, and had been given a variety of privileges by the state in recognition of the social service they provide in offering secure savings and mortgages. The new, more competitive market of the 1980s, accompanied by the opportunities for good profits as the size and number of loans increased, put pressure on traditional habits of caution and probity. Decision-making times on advances were reduced, income multiples increased and percentages of loans to value rose beyond 100 per cent to cover legal costs as well as the cost of the property. At the same time mortgages started to become more complex as lenders developed new products in order to compete with each other. Cash-backs were offered as inducements, low-start mortgages tempted the first-time buyer, interest-only mortgages linked to endowment life assurance were increasingly pressed on customers as a better and tax-efficient way to borrow, the benefit to the lender being the handsome commission from the insurance company.

When the market crashed, the ensuing slump lasted with great intensity for five years, and even in a decade prices had barely recovered to their nominal levels at the 1988 peak, let alone the levels accounting for inflation. Hundreds of thousands of homeowners had their properties repossessed, unable to repay excessive loans, and millions were trapped in negative equity, with the size of their loan higher than the value of the property. Many were subject to the failure of life assurance policies to build up enough funds to be able to pay off the loan and borrowers were advised to increase their life cover. Mortgages continued to diversify, with links to pensions and personal equity plans and loans at fixed and discounted rates. Yet the legislation introduced to regulate the financial sector in 1986 (the Financial Services Act) excluded mortgages, partly because they were not seen as investments, a curious notion in the minds of most borrowers, but also because mortgages had been fairly straightforward, and lending had not been subject to abuse. In the wake of the crash and complaints of overlending and other abuses, the lenders came under increasing pressure to be formally regulated under the 1986 Act, pressure which was renewed as the incoming Labour government announced a review of regulation in the whole of the financial sector and the creation of a new regulator within increased powers, the Financial Services Authority (FSA) (Clarke 1998a, Chapters 1 and 3).

The response of the CML was to attempt to construct a code of conduct that would ensure treatment of potential borrowers that was more or less comparable to what they might expect under the Act. It proved difficult to achieve agreement on anything substantial and genuinely binding, however, and consumer groups derided the first proposal as worthless. A second attempt was improved but still limited and it was evident the Council was having difficulty carrying all its members – the great majority of lenders – with it. Some regarded too stringent a code as a dangerous restraint on their freedom to innovate and market new products and so compete. With the new FSA regime likely to take several years to be finalised, at the end of the 1990s the threat of inclusion in formal regulation hung like the sword of Damocles over mortgage-lenders. Mortgage-lenders may have been willing to play a game of chicken with the government, challenging it to take the risks of intervention and handle the costs, while offering reassurances that past errors would not be repeated.

Another example of an industry under pressure to clean up its act illustrates that the advantages may not always lie even in 'the last resort' with the state. When Diana, Princess of Wales, was killed in a car-crash in Paris in 1997 it was widely claimed that the reason the car was travelling at such speed was to escape the paparazzi photographers who were following it. The issue of the relationship between the press and the British royal family had been hotly debated for several years beforehand as the Royals were understood to have become a minor industry in their own right, with rising numbers of specialist reporters and photographers allocated to cover them and high fees paid for 'intimate' or 'revealing' pictures. Interest became heightened following the separation and divorce, first of the Duke and Duchess of York, and then of the Prince and Princess of Wales. Nor was press intrusiveness limited to the royal family, who after all, had a capacity to protect and seclude themselves. The snatching of a photograph of an actor in a television soap opera while recovering in hospital from an accident was particularly complained of, for example, especially when it was discovered that he and others like him had no right of legal redress.

The iniquities of the tabloid press were widely debated in Parliament and in the broadsheet press, and in response the informal machinery for redress began to be further developed. This had been in existence for many years as the Press Council, established by and substantially dependent upon the Newspaper Proprietors Association. As royal coverage increased, it became evident that, whatever the professed views of the public, they were prepared to buy papers featuring new revelations. Intrusion took another step forward with the publication by a tabloid paper of a tape-recording of a mobile phone conversation between Prince Charles and his lover, Camilla Parker-Bowles. The response of the government was to threaten legal restraint on the press if the informal machinery was not improved. This took place in several stages, and the Press Complaints Commission became more substantial and stringent in its actions and its membership and standing became increasingly independent of the newspaper proprietors and editors. The difficulty was the nature of the sanctions that might be imposed. Since the papers made unquantifiable extra profits from intrusion, financial sanctions were not realistic unless so high as to be potentially damaging to the paper. The real penalty that was feared was suspension of publication, but this, especially if imposed by the state, looked remarkably like censorship and suspension of press freedom. In the event, the entirely painless apology after the event continued to be the main penalty.

Matters were complicated by several additional factors. As the tabloid press continued its intrusive habits with royals and others, the minister warned that they were 'drinking in the last-chance saloon'. The minister succumbed to press revelations of his affair with an actress, an issue made all the more poignant by the government's decision during this period to attempt to regain the moral high ground and recover electoral support by a campaign of 'back to basics' in which 'family values' featured prominently. The difficulties for the government in legislating to control press excesses lay in two directions. First the constitutional position of the press is not formally protected in Britain as it is in

America; nor is there any freedom-of-information legislation, although it has often been promised. The danger in legislating to restrain the press lay in the fact that it would open this entire constitutional issue, and editors not surprisingly made much of the fact that it would be hard to frame legislation distinguishing in all cases between what the public might be interested in (the sexual peccadilloes of ministers, for example) and the public interest (the financial or political corruption of ministers, for example). The function of the press as watchdog, its fourth-estate role in restraining bad government, might well be compromised.

Secondly, it became evident that at least in some cases, the objects of intrusion were by no means innocent in their relations with the press. The chairman of the revamped Press Complaints Commission complained of the tabloids 'dabbling in the stuff of other people's souls', only for it to transpire that Princess Diana had actively and directly collaborated with the author of a book about her life. It gradually became evident that she was quite ready to cultivate journalists and offer photo opportunities outside her formal appearances if it suited her purposes. Other victims resorted to agents to handle their stories, and contrived first to have events portrayed in a more favourable light and secondly to sell their stories for substantial sums. The victims, it seemed, were not passive, and could at times fight back, and might in some cases bear some responsibility for their press exposure. The outcome was that, despite promises by the Major government to legislate on at least some aspects of the problem and a debate on the possibility of a privacy law (as in France), no action was ultimately taken, and the death of Princess Diana and the ensuing public manifestations of grief served as a warning to the press that their circulations as well as their reputations might be at risk.

These examples lead us into the debate about industry self-regulation rather than state regulation which will be pursued further in later chapters. Clearly there are benefits in industries acting to improve their own conduct if they are genuinely willing to do so. The problem lies in motivation, and behind motivation usually financial interest. Smith and Tombs (1995) who are sceptical of the potential for industry self-regulation, cite a telling example from the chemical industry.

On the basis of a good safety record, the Union Carbide Corporation (UCC) plant at Institute, Virginia, had been exempt from the Occupational Safety and Health Administration (OSHA) inspectors as one specific element of more general moves to deregulation in the USA. There was no denying that UCC had, latterly at least, what appeared to be a relatively good safety record in the USA. But history and reassurances counted for nothing when aldicarb oxine leaked from the Institute plant in August 1985. Following this incident the OSHA sent several teams of inspectors to conduct a ‘wall to wall’ inspection and this led to 221 charges of ‘wilful violations’. The OSHA and UCC eventually reached a settlement which saw the company fined just over $4400 for five serious violations, on the agreement that the others would be corrected. Of particular interest here is the fact that US Labour Secretary Brock revealed that, had UCC actually kept accurate records (rather than those which formed the basis of their exemption from inspections), then their accident record would have been ‘substantially higher’ than the US chemical industry average (Smith and Tombs 1995, pp. 628–29).

This example sheds an interesting light on Gunningham and Rees’ (1997) support for the potential of industry self-regulation through the mediation of industry associations. They cite a number of examples, but three are particularly relevant here. Following the serious radiation-leak at the Three Mile Island (TMI) nuclear electric generation plant at Harrisburg, Virginia in 1979, the industry very rapidly responded by creating their own inspectorate, the Institute of Nuclear Power Operators (INPO), with a budget of $54 million and a staff of 400, which informs plant operators of the safety rating of their plant and so acts to create competition to improve safety standards. The authors provide some details on the effectiveness of INPO and there is no reason to doubt their conclusion that ‘the safety of nuclear plants has increased significantly since TMI, and there is wide agreement among knowledgeable observers that INPO’s contribution to improved nuclear safety has been highly significant’ (1997, p. 369). The question is why and the answer is obvious. Nuclear power has been banned in some countries as unacceptably hazardous. In the UK it is effectively being phased out as growing evidence of leaks and hazards maintains public anxiety and the costs of decommissioning plants are revealed to be huge and the process to be highly problematic. There are a number of other sources of power available in America and it was quite likely that the effect of TMI would be to create a public insistence that states refuse to permit nuclear plants.

Contrast this with two other examples. The Sustainable Forestry Initiative (SFI) was developed by the American Forest and Paper Association (AFPA) in response to ‘evolving public concerns’ about timber companies and their ‘environmental impacts on wildlife and forest systems’ (AFPA 1996 in Gunningham and Rees 1997, p. 379).

This constitutes an explicit move from a past in which 'forest product companies owned and managed forests primarily for a simple economic objective, profit from timber production' (op. cit., p. 377 AFPA 1996). The SFI is the start of a process that might in due course reach a point of stringent inspection and standardisation comparable with INPO but at present is at least significantly a profession of good faith, which offers the benefit to participants of being able to declare their commitment to the initiative and to adorn their products with its logo and so promote sales to concerned citizens and perhaps sustain slightly higher prices. The AFPA recognised this weakness by creating an independent panel of experts to review self-reported data and meet company officials to discuss their operations.

In the case of the chemical industry, the pressures arising from chronic hazards and repeated failures such as those referred to by Smith and Tombs, and especially the major disasters such as the massive deaths and injuries caused by the chemical plant at Bhopal, India constructed by Union Carbide, were greater than on the timber industry, but unlikely to be a terminal threat as in the nuclear industry, though as Smith and Tombs remark, one recourse of the chemical industry has been to move its more hazardous processes to less effectively regulated jurisdictions. The chemical industry's response was a programme called Responsible Care. Like INPO it involves a monitoring process set up by the industry with the invitation to the public 'Don't trust us, track us', but as Gunningham and Rees note, the industry is still in the process of moving to third-party verification, and the internal debate which has been in prospect during the decade of Responsible Care's existence over threats to firms' autonomy and the confidentiality of their processes and the risks of providing data that could be used against them by state inspectors and environmental activists is far from over. In consequence, the monitoring system is far from perfect. 'The industry has not yet developed the analytical capacity to examine the data with sufficient care, and it lacks the institutional mechanisms for using the information in a way that significantly enhances the accountability (and self-discipline) of chemical company officials' (op. cit., p. 383).

The role of industry associations should not be seen entirely in the light of naked self-interest however, important though that is. In Britain an important catalytic role has been played by the Office of Fair Trading (OFT), created in 1973 with the dual purpose of promoting fair trading and consumer protection in all aspects, and to monitor anti-competitive conduct of all kinds, including the creation of cartels and anti-competitive mergers, which it can investigate and refer upwards for sanction, as we shall see in the next section. One of its positive roles has been to work to develop industry codes of conduct. An early success was with the travel trade when the collapse of the package-tour operator Courtline left holidaymakers stranded abroad. The OFT eventually persuaded the Association of British Travel Agents to require its members to lodge a bond with the Association to cover holiday-makers in the event of members' insolvency. The result is that confidence in the package-tour industry has been maintained despite the regular failure of operators, usually small but sometimes substantial. This is an obvious minimum solution. The OFT has, however, had some success in other less likely areas such as car repairs, second-hand car sales, shoe retailing and double glazing. It cannot be said here that powerful industry associations have adopted stringent codes of practice, but it is a start and a vital part of a process central to regulation: identifying problems, requiring redress and beginning a process of raising standards of expected conduct and reliability. Market conditions surrounding the product or service may not be conducive to rapid progress – there may be too many cowboys and entry to the industry may be cheap and easy – but the establishment of codes does contribute to the creation and articulation of legitimate consumer expectations and serves to put consumers on their guard that vigilance, where *caveat emptor* still prevails, is called for. Where, as is increasingly the case in consumer matters, redress, repair or replacement is almost automatically required by law in the face of product or service failure, the OFT can contribute to ensuring that legal protection is enforced and that redress arrangements are effective.

The examples so far have not included those in which industry associations have proved critical in direct negotiations with the state. This relationship is often referred to as corporatism in recognition of the structural similarities of the arrangements which arise with those promoted in European fascist regimes from the 1920s to the 1940s. The objective of fascism was to outlaw, outflank and suppress class and class conflict and hence introduce sustained order and stability. One means of doing this was to ban parties of the left and trade unions. A positive side was to give representation to industries, trades and professions through new 'corporate' bodies, where their concerns and needs could discussed with the state. With the defeat of fascism and the establishment of welfare states, the management of class conflict took a different turn. The new corporatism became the constitutional expression of social democracy, an attempt to include all parties in continuing debate and so practically to reconcile conflict. Thus trade unions and labour and socialist parties sponsored by them prospered and were invited to put their views both to governments and to various parts of the state. Health and safety legislation in Britain, for example, was consolidated and reviewed in the Health and Safety at Work Act 1974, which gave rise to the Health and Safety Executive, broadly the counterpart to the OSHA in America. The committee of enquiry leading to the Act was led by a former chairman of the National Coal Board, Lord Robens, and union submissions to the enquiry were influential. The philosophy of the Act was explicitly collaborative, seeing plant- and worker-safety as the concern of workers, management and the state. The idea that class conflict could be negotiated away by allowing management and unions adequate representation at all levels in tripartite relations with the government reached its fullest extent in the 1970s, when these arrangements were regularly used to deal with strikes, and with the consolidation of industries by merger and takeover. In the event they proved unsuccessful and that led directly to the election of the Thatcher administration in 1979, committed to dismantling corporatism and curbing the power of the unions. Thatcher achieved substantial success in the latter respect, but less so in the former, at least in the respect that they remain industries, even after the substantial privatisation of nationalised industries, where the state has a substantial interest.

One such is plainly the British National Health Service (NHS), which has led to the private medical sector remaining small in Britain. The state is hence the principal purchaser of, for example, pharmaceuticals and, as Sargent's (1986) review of development shows, it acted over time more or less to require the emergence of an effective industry association to negotiate with the state. The interest of the NHS was obviously to minimise the costs of its drugs bill while securing good quality. The industry is concerned to maintain its profitability, but this is problematic in two respects. First the cost of research and development of significant new drugs, those that achieve major remedies where none existed before, is enormous and unpredictable. Only by being large enough to invest in a variety of research lines can modern pharmaceutical companies hope to survive as major players. When they do achieve a breakthrough, however, they can charge high prices and recover their costs during the lifetime of the patent – usually twenty years. Thereafter the drug can be legally produced by others, who may introduce modifications and cocktails designed to improve treatment. Careful marketing and branding of such products, both to the public for over-the-counter drugs and to doctors for the others can allow drug companies to continue to charge significant premium prices.

The simple issue as it first presented itself was, were the drug companies charging fair prices for their products? Significantly the manufacturers believed that in general they were, but accepted there were instances of overcharging and therefore agreed to accept an external check. Since the government believed that overcharging was more significant, this implied a need for negotiation and verification machinery. This produced initially the voluntary price regulation scheme agreed with the Association of British Pharmaceutical Industry (ABPI), which established a negotiating committee to set up the scheme. Meetings ran from 1954 to 1957 and the first scheme was finally introduced in 1958. The difficulty was that not all the firms were willing to abide by the scheme and disclose price and cost information. In particular, the Swiss-based firms refused to participate until 1960. Although savings were not anything like what the government anticipated, both sides held that the initial three years had worked well enough for the scheme to be continued and a second version was agreed in 1960. As before, however, foreign-based companies proved problematic. The American company Pfizer refused to reduce its price for terramycin in 1961 and the minister approved the importation of cheaper sources of the drug and was supported by the courts in doing so. In 1963 the Swiss company Ciba Geigy refused to negotiate price reductions, prompting the Treasury to pronounce that 'whatever form or forms of voluntary price restraint are agreed upon with the ABPI, they must clearly be understood to be binding on all its members' (Sargent 1985, p. 115). This led to a further review. In the course of these changes the ABPI gave more substantial powers to its regulatory committee and progressively streamlined its governing council, so that it gradually took on more authority as power was effectively foisted upon it by an insistent state. The third scheme in 1964 extended to all speciality products prescribed by GPs, increased the period of lack of intervention for products based on substantial research to four years, but denied any freedom to products whose active ingredients had been known for five years. Allowance was specifically made for research costs in calculating prices. In effect, the scope of the scheme was widened to cover about half of all NHS drug purchases, and provision was made for price agreements to be backdated. Controversy did not, however, die down and a committee of inquiry was appointed, which reported in 1967, attacking the industry for excessive profits and recommending stricter scrutiny of how its returns were being constructed. It recommended that the government use its powers to seek other supplies of drugs if firms behaved unacceptably, provoking a warning from the APBI that more stringent restraint would undermine profitability, and in particular the willingness of companies to take the big research risks necessary to achieve major innovations.

This was reflected in the fourth variant of the scheme in 1969, which for the first time accepted the objective of maintaining a strong, effective and profitable British pharmaceutical industry. It also, however, introduced tougher requirements for company returns to establish acceptable prices. There was additional input into restricting profits and price increases and this proved particularly problematic in a period of rising inflation. Data showed falling profits on sales both to the NHS and abroad, and the industry pressed for yet another revised scheme. The new scheme in 1971, the fifth, did not accede to this demand for radical change, and indeed pressures increased. In part these arose from the government's efforts to control inflation by freezing both wages and prices by statute and in consequence restraining drug price increases. A political storm arose over the refusal of Hoffman La Roche to reduce prices for Librium and Valium, the minor tranquilizers, and the discovery, when the case was referred to the Monopolies Commission and Roche withdrew from the VPRS, that the active ingredients of the drugs were available at £9 and £20 a kilogram, where Roche sold its products at £570 and £920 per kilogram. Eventually Roche rejoined the scheme and repaid £8.25 million. It proved something of a watershed as the new Labour government in 1974 considered nationalising parts of the industry and legislated in the Health Act 1977 to provide the minister with the power to fix drug prices by order if necessary.

The scheme that ran into the 1980s dropped the word voluntary and began to look more like direct state regulation, with the industry association merely acting as a conduit. The government addressed wider issues by constructing a league table of company profitability in relation to the average for British industry. Various allowances were made for exceptional profits in individual years and for exceptional efforts, but more and more information was demanded and collected on promotional expenditure, stock levels, exchange rates and inflation rates, and was used in calculations. The outcome was increasingly direct negotiations between the state and companies and an acceptance that the industry association could not, despite its increased organisation and authority, act effectively for all its members. At the same time Sargent points out that the government did not use its powers under the 1977 Act. The industry still preferred negotiation to state control, since, if this once became a pattern, companies' room for manoeuvre would be likely to be further restricted. On the other hand, companies were in the end unwilling to cede enough authority to the ABPI to allow it to negotiate from strength and a fully corporatist arrangement never quite took root and gave way effectively to state regulation.

Cartels and market domination

One obvious way in which businesses can secure their profitability is to exercise control over their prices and market share and frustrate the pressures to competition. There are two broad routes to achieving this which are not mutually exclusive: reaching agreements with competitors through cartels and being big enough to dominate the market. Cartels may be established for a variety of reasons, including simple greed. Where there are direct relations with government, central or local, there is always a risk of corruption becoming established and contracts allocated only to a charmed circle who offer kickbacks to the relevant politicians and officials. Economic pressures to the creation of cartels exist, however, where for example the product in question and its production technology are standardised. Firms hence find it impossible to compete by innovation, and competition, if pursued, becomes mutually destructive. In these circumstances it makes little difference whether there are a number of competing firms or very few. Thus in 1991 the Office of Fair Trading, which has the responsibility for investigating cartels in Britain, discovered 65 local agreements in ready-mixed concrete for public and private construction projects involving dozens of companies large and small. Some of these had been the subject of earlier investigations and orders by the Restrictive Practices Court to end the agreements. Indeed, a few months earlier, four ready-mixed companies were found in contempt of court for breaching orders to end cartel agreements, and two former managers were warned that they were lucky not to be jailed. Companies and employees were fined.

The instructive feature of this example is the evident willingness of companies and their managements to persist with cartel agreements even after detection. It could be said that one reason is the time taken for enquiries to reach court and the limited sanctions imposed when they do. Not all industries are as prone to cartels, however, and innovation and diversification are often alternative strategies. At least part of the reason lies in management perception that agreements are essential to profitability. The question which then arises is, what level of profitability? The Director-General of Fair Trading claimed of the ready-mixed concrete cases that the national cost of the cartels was £100 million just to local authorities (*The Times*, 19 August 1991; OFT Press Releases 28 September 1990, 25 February 1991).

An alternative strategy is to drive competitors out of the market so that those who remain can control it. This is an accusation which has often been made of the oil giants, who have also frequently been accused of price-fixing. The accusations have been difficult to sustain but they do alert us to a more problematic variant of price-fixing, namely passive price-following. In markets like oil, where the impact of external factors affecting raw materials is the same for all or most producers, and where production technology is more or less established, and the capital investment and distribution channels established, the remaining players know that any gains achieved by price competition will be short-term. Hence, while opportunist price wars to gain market share are not unknown, for the most part price-changes are responses to changes in costs of supply and there is no need for formal cartel agreements. Not that major corporations are unwilling to enter such agreements if they believe it is necessary. ICI, the British chemicals giant, was fined by the European Commission for participating in cartels covering plastics and pvc, and soda ash, one of the basic ingredients in glassmaking. The leading glass manufacturers in Europe – one British and one French – have also been accused by the European Commission of dividing up the glass market between them in an anti-competitive fashion. The Commission's attempts to demonstrate price-fixing in the car markets, with wide disparities in prices for the same models in different EU countries in the 1990s was, however, frustrated by the capacity of manufacturers and distributors to argue that local conditions imposed significantly different demands.

The strategy of using price-competition to drive competitors out of the market was evident after the privatisation of bus services in Britain in the 1980s and 1990s, which saw a few companies growing extremely rapidly by taking over local bus companies in city after city. The tactics employed to secure the takeover of companies reluctant to sell included the establishment of new buses competing directly on the same routes, as the privatisation legislation allowed, and at fares progressively reduced, to zero if necessary, in order to attract customers. Once the takeover was achieved and control of the services in the area consolidated, prices were raised and services pruned to raise profits. Much the same outcome, but not necessarily through predatory pricing, was to be seen in the American internal airline industry with deregulation in the 1980s stimulating a wave of competition and price-cutting and the introduction of minimal-cost 'no frills' flights. While this undoubtedly shook up the industry and led to serious problems and insolvency for some major operators, it eventually self-destructed as profit margins were squeezed unsustainably and crashes in aircraft run by cut-price companies raised safety fears. By the latter 1990s the number of operators had fallen and prices had risen markedly.

Another reason for cartel agreements is evident in one of the most celebrated cases, the heavy electrical equipment cartel in America, which ended in fines and prison sentences in 1961 (Geis 1967). The case originated in complaints from the Tennessee Valley Authority that they were receiving identical bids for tenders for highly technical electrical equipment. Four grand juries in 20 indictments accused 45 individuals and 29 corporations who almost all pleaded guilty or no contest. It transpired that organised meetings, referred to as 'choir practice', had been going on at varying levels of intensity and effectiveness since 1946, and some defendants' first experience of price-fixing went back to the 1930s. Meetings decided market share for various products based on past market share. The managers were not at the top of their corporations, though some ended their careers near it and deliberately violated explicit corporate policy against cartels, though in a good many instances with tacit approval. The object of the cartels was widely emphasised as price stability. While this is obviously to some extent self-serving, it is an important consideration, particularly in an industry where design and production times may be quite long and project costs quite large. If it was indeed true – and there seems to be some evidence that it is – that prices were moving rapidly and, as one participant put it, 'chaotically', then life would be difficult for all participants regardless of their efficiency and innovation. In whose interest would it have been if a major electrical engineering company had become insolvent as a result?

This leads us to the ambivalent features of cartels. While they are likely to impose costs on customers, they are not without their benefits. Thus, to return to the two examples from the previous section, the attempts by the state to prevent price-exploitation by the pharmaceutical industry in Britain was initially conceptualised in terms of limiting excessive profits, the problem being to identify what 'excessive' meant. As time went on, however, the state began to accept the importance of other aspects of the industry. As it prospered it became a substantial exporter and earned foreign exchange. It became a large employer and one involving high technology in which an advanced industrialised nation would want to excel; its investment, including its investment in research, was significant; it made a significant contribution to taxes. Given that overseas companies, notably Swiss and US multi-nationals who increasingly dominated world markets, were well represented in Britain it made sense not to risk driving them out to some other, more hospitable, country.

Rather different arguments apply to mortgage-lending. Up to the deregulation of the mid-1980s, lending was dominated by the building societies, which traditionally operated a publicly endorsed cartel controlling interest rates. This was beneficial in reducing volatility in rates and it was accompanied by a paternalistic style of lending which involved interviewing the would-be borrower, advising on his (usually not her) circumstances and potential change in them – how secure was his job, would his overtime continue, when did he envisage his wife would have children – and cautioning restraint on the amount of the loan, which in any case was not on offer until the borrower had demonstrated good faith by saving with the lender perhaps 5 per cent of the purchase price. One consequence of this was delay in obtaining loans, and queues for mortgages, a situation which deregulation and the entry of other lenders into the market remedied decisively. The downside, however, was that the increased competition ended paternalism and turned mortgage-lending into a marketing and selling operation, much like soap powder and breakfast cereal, with less and less attention to the risks involved in what is for most people by far their largest and longest-term financial commitment. For many it ended in tears, as we saw earlier in this chapter.

Other considerations and public benefit can also sustain agreed cartels. The food industry is a leading example of interventions of various kinds – production quotas and subsidies, export subsidies and import tariffs, for example – as well as cartels to address the tendency of food prices to extreme volatility – people still need to eat even after a bad growing season and farmers can find themselves unable to sell crops at all after a good one. The Milk Marketing Board was established in Britain in the interwar years, to overcome the effects of the depression and the domination of the market by a few dairy products companies. In effect, the government, under legislation in 1931, sponsored a producers' co-operative and the Board remained a private body controlled by farmers, even though the state could set prices, notably the maximum retail and wholesale prices. The scheme came into its own as a means to secure the regular supply of milk to the whole nation during and after the Second World War, when supplies could not be supplemented with imports. Dairy farmers could be licensed to sell their milk direct, but most opted to go through the Board. Expansion of demand was promoted over time by advertising milk as healthy, and diversifying into other milk products – cheese, butter and yoghurt – with the Board's dairy products arm, Dairy Crest, becoming the largest buyer of milk with over one-quarter of the market. The state bought milk in some quantity directly by supplying a bottle to all schoolchildren daily. By the 1980s these concerns with adequate nutrition had shifted to focusing on obesity. Free school milk and the requirement to provide cooked lunches were abolished and the MMB dismantled as price became the leading issue. Supermarkets wanted to negotiate the best deal for retail sales, but this threatened to reduce total milk consumption by under-cutting doorstep milk delivery prices. Paradoxically Britain was almost the only country in Europe to maintain prices, with their capacity to sustain consumption. The MMB was replaced not by a free market system but by quotas derived from the EU Common Agricultural Policy and the creation of a producers' co-operative, Milk Marque. Although this was intended as a means of removing state-intervention from the milk market, it was interesting that the other major milk-producers, such as Northern Foods and Unigate, now castigated the new arrangements as likely to drive up prices. (*The Times*, 24 August 1994; *Independent on Sunday* 12 January 1992; Grant 1986.)

Attempts to end cartels and market domination are not necessarily without difficulties, quite apart from the recalcitrance of participants. The case of beer in Britain, in which the reverse took place of what was intended, is instructive. Historically breweries established themselves in towns and cities and secured their markets by building pubs which they controlled as franchisers tying licensees to a single supplier of beer. Given the weight and bulk of the product, this effectively resulted in time in a pattern of local market-domination by a few brewers within a day's distribution round for horse-drawn brewers' drays. With motorised distribution, the national motorway network and advertising to establish brands, along with the advent of pasteurised beer and lager, which have longer shelf-lives than live cask ale, local breweries were increasingly taken over and a few national giants began to dominate the market, though some regional brewers continued to prosper, and foreign brewers also began to enter the market in a serious way. One outcome was that the big brewers came to own thousands of pubs. In 1986 the OFT referred this matter to the Monopolies and Mergers Commission, which recommended in 1989, after its enquiry, that the maximum number of tied pubs to be held by any brewer should be 2000. This required 22 000 pubs to be sold, and the brewers made vigorous representations that this was oppressive since any attempt to dispose of that number would push market prices down enormously. The minister concurred and halved the sell-off figure, but also insisted that tied licensees be permitted to sell at least one guest beer to promote competition. Divestment was slow and it did indeed prove hard to find buyers, not least because the brewers naturally sold off their least profitable, worst-located pubs in a market in which the long-term patronage of pubs as local leisure centres was in decline. In the event, only two large purchases of pubs were made, both by companies which later became insolvent. Brewers responded by investing in the development of their most promising premises and by forming alliances with foreign brewers to boost sales of lager, which was extensively and successfully promoted as the fashionable and young person's drink. A shift was achieved in the balance of consumption towards lager, with its higher price and profit and longer shelf-life, and the regional brewers began to close and sell their brewing to the majors, who could produce more cheaply. The net effect was a more rapid increase in the price of beer, a decline in the number of pubs, and an increase in the dominance of the market by the major brewers, now in alliance with large foreign brewers.

As these examples imply cartels, market dominance and competition policy are often fraught matters, even though examples exist of obvious conspiracies of price exploitation and obvious oppression of legitimate, usually smaller, competitors. Attitudes to cartels and market dominance vary substantially internationally, with America occupying the position of strongest support for maintaining competition and attacking 'trusts' and cartels, and France, Germany and Japan in varying ways adopting the opposed view that major corporations dominating industries with the support of banks, who may be major shareholders and lenders, can be effectively managed and nurtured by the government as the best prospect for long-term stability and for participating effectively in international markets. The cosiness that these arrangements imply can have disastrous consequences if it is not carefully restrained, as recent scandals in Japan have demonstrated, with relations between politicians, civil servants and business becoming biased and corrupt, and support for firms extended beyond what is prudent. The same can be said, in some respects, of France, where a powerful and centralised state has found itself in trouble in the past in supporting the car-maker Renault for reasons of employment and national prestige; where the bank Credit Lyonnais became a national scandal in the 1990s as its enormous errors and excesses, constantly underwritten by the state, were exposed; and where the airline Air France led to bitter conflict with the EU Commission and with other EU countries in the latter 1990s over a 'final' subsidy of £3 billion, as EU airlines were supposed to become independent of states and no longer constantly subsidised as a matter of national honour.

Britain occupies a position somewhere between the American and the 'Euro-Japanese', with a rather pragmatic view of the appropriate action to take against cartels and restrictive trade practices (Craig 1987). Unlike America, where federal concern dates from the Sherman Anti-Trust Act of 1890, substantial British legislation is all postwar, with the Monopolies Commission created in 1948 to investigate firms with more than one-third of markets and report on the consequences for the public interest, followed by the Restrictive Practices Court in 1956, before which cartels and other restrictive practices must be acknowledged, but which may permit them if they are judged to be in the public interest. As discussed earlier, the Office of Fair Trading was created in 1973 to investigate cartels and restrictive trade practices and to advise on anti-competitive mergers. The significant point is that all these institutions and the various additional legislation on competition and related matters carefully leave final decisions with the politicians in all substantial matters. As Craig points out, there is no easy solution to what constitutes 'anti-competitive'. The 1948 and 1956 Acts concentrate on form – does a firm have a dominant position? This is compromised by the recognition that at times market consolidation may be essential because the capital costs of participating in industry have increased, or because international competition requires larger players. To those ends the Labour government of the 1960s created the Industrial Reorganisation Corporation, with the specific objective of modernising British industry and creating larger businesses with greater capitalisation capable of competing in world markets, but likely to be dominant in domestic ones. By contrast, the Treaty of Rome, the foundation of European law on competition, and the 1980 Competition Act focus on anti-competitive practices. The difficulty even here, as Craig remarks, is that precise rules are prone to irrelevance to particular cases and discretion to accusations of arbitrariness. The fact is, however, that this is an area where almost every case seems to throw up new difficulties, both in its implications and in those of any projected remedy. It is hence probably inevitable that 'the public interest' remains vague and that politicians have to exercise judgement.

Although British policy moved towards tougher enforcement at the end of the 1990s with the OFT given additional powers of investigation, and sanction raised to include fines of up to 10 per cent of an offender's turnover, similar to EU sanctions, which were also boosted by additional investigative powers, cases continued to require political judgement as the proposal of BSkyB to take over Manchester United Football Club amply demonstrated.

The evidence of economists, though of interest, does not seem decisive. Utton's (1986) work on oligopoly and market dominance offers greater clarity by distinguishing kinds of market concentration. He is able to show that simply looking at markets where, say, the top five firms have most of the market, fails to discriminate between situations where there is a real advantage and those where it is limited. Utton distinguishes dominant market firms, where the leading firm has 50 per cent or more of the market and the next largest half that size, from concentrated and loose oligopolies. Dominant firms were able to earn twice the industry average, where other oligopolies only average 16 per cent above average. Further, dominant firms achieve profit-stability twice as great as that of followers over time. Utton found some evidence that the position of dominant firms was subject to challenge as time went on, and that the capacity to take over challengers appeared to be vital in restraining this.

This takes us into our final topic for this chapter, mergers and acquisitions, which is best introduced by Fligstein's account of the struggle between business for security, and the American state for limits on price and profit exploitation. As he puts it in a recent consolidation and development of his views, 'the social structure of markets and the internal organisation of firms are best viewed as attempts to mitigate the effects of competition with other firms.... Property rights, governance structures, conceptions of control and rules of exchange define the social institutions necessary to make markets. Economic worlds are social worlds; therefore they operate according to principles like other social worlds. Actors engage in political actions vis a vis one another and construct local cultures to guide that interaction' (1996, p. 657).

Nor is it only business that is concerned to maintain order and stability in markets. 'State actors are constantly attending to some form of market crisis or another. This is because markets are always being organised or destabilised and firms are lobbying for state intervention' (p. 661). Relations between the state and business is a topic to which we will return in Chapter 4. The point for present purposes is that, while there are advantages to both from stable and orderly markets, in the first place stability tends to break down sooner or later, and secondly the state may view the public interest as not best served by the terms on which industry achieves stability.

Fligstein (1990) maintains that the struggle between the state and business gave rise to four strategies. Each of these was stimulated by changes in the economy as a whole and by successive economic crises, as well as by the state's reaction to previous attempts to achieve control of secure profitability. Each strategy involved a different corporate form to achieve control and the dominance of a different division or formation within the corporation to implement the strategy. There is no space here to detail the wide-ranging evidence Fligstein brings to bear. The point for present purposes is the continuing underlying objective, and, it should be added, the explicit rejection of market competition and efficiency as an explanation.

> The central argument I propose here is that managers rarely know what is economically efficient. They have a sense of controlling a market or market share, and to some degree can control costs. But the driving force for managers, just as it is for any kind of social actor, is to preserve their organisations and further their individual and collective interests. To do so they must define their situation, including what constitutes a market. In that process they will construct a conception of control that includes strategies and structures.
> (Chapter 9, p. 371)

Thus the first reaction of the big firms as they emerged at the end of the nineteenth century was to attempt to eliminate over-capacity in markets, which led to boom and slump, by direct control, including predatory pricing, covert purchase of competitors' shares to acquire control of them, formal cartel agreements and the creation of monopolies. This 'robber baron' period led to anti-trust legislation outlawing these tactics. The business response was manufacturing control, which involved vertical integration, passive price control by market leaders, price following, and mergers, creating oligopolies. Although there was support for this from the New Deal, and the National Recovery Act explicitly supported price and profit stability and its capacity to sustain employment, the NRA was held to be unconstitutional in its restraint on competition. Accordingly the third strategy was the development of sales and marketing and the creation of the multidivisional firm to service different product lines, which in turn were protected by branding, which had the effect of insulating them from competition by emphasising their uniqueness. State attacks on monopolies were avoided by the creation of conglomerates by the merger and acquisition of companies producing unrelated products and services. This, however, created its own problems as the profitability of different parts of the conglomerate varied with time and it was hard to tell which were beneficial. In addition, anti-trust investigations again began to question them as undue concentrations of market power. This led to the final strategy of finance control, using accounting techniques to assess the costs and profitability of all parts of the business. The strategy then required the sale of unprofitable elements and the acquisition of profitable ones from elsewhere. Attention hence shifted away from product research and development towards short-term profitability. The object became to sell less profitable parts of existing and newly acquired firms and retain the more profitable, so increasing earnings ratios and hence share prices and maintaining a base for further acquisitions. This constituted a move at its extreme almost to dealing in companies rather than attempting to generate real internal growth. Provided few restraints were imposed on mergers and acquisitions as an issue of turnover rather than market concentration objections by the state were avoided. This was the case in the 1980s when this strategy reached its peak.

Takeovers, mergers and manias

It is impossible adequately to represent Fligstein's detailed evidence in a brief account. The important point is that the elaborate and continuing struggle between business, attempting to secure profits, and the state, attempting to re-establish competition, is a political one and contingent: such struggles and changes were much less characteristic of those countries which embraced cartels and market dominance as opportunities for planned growth. Secondly, Fligstein's is a vivid account of the extent and persistence of business in regulating itself to secure its own objectives. It also illustrates the phenomenon of takeovers and mergers as a long-term feature of capitalism, especially in those countries which venerate competition, for in those which are more ambivalent, takeovers except by consent are much harder to achieve, as the legal constitution of companies, the interests of the stakeholders such as the employees, the concerns of the state, and the deep involvement of bankers as long-term lenders and shareholders constitute considerable constraints.

The difficulties with takeovers and mergers then lie in a number of directions, but the crucial question arises in each case: whose interests are being served? While there are often claims that takeovers result in larger, more effective and competitive firms, this is, first, often a rationalisation to conceal other objectives; secondly, even if honest, an objective which is not necessarily realised; and thirdly if it is realised, it may raise the further question of whether the new giant will be able to dominate the market. Thus there was a nice irony in the way that large mergers, almost all by agreement, that characterised the Anglo-American and European takeover market in the latter 1990s, moved out of the manufacturing sector, where the 1980s boom was concentrated, and into finance and services. The arguments in respect of banking, insurance, airlines and telecommunications, for example, for mergers or strategic alliances, such as that between BA and American Airlines, was that global markets would require new large, global firms, and that smaller competitors would be unable to compete and invest on the necessary scale. All very attractive, but does this not imply a world economy dominated in industry after industry by a few giant multinationals who effectively administer their markets? Such a process might begin with competition and no doubt very large investments will be involved, but the scenario explicitly envisaged looked rather less likely to be very competitive. Nonetheless general sentiments seem to favour such deals, backed by national concerns that 'we' should have at least one or, in the case of America, retain the majority of the players.

It is worth pausing briefly over the motivations of takeovers at the case level before looking at the problems generated by periods of takeover boom. Takeover may be intended to strangle a small new competitor, or it may be used to provide a level of investment and support an innovative competitor cannot otherwise raise. It may be a way of diversifying into a new area and acquiring the goodwill, expertise and staffing to succeed rapidly. It may be the opportunistic buying-up of an ailing firm whose assets can be sold off at a profit, though this raises the question of whether it should be closed down or revitalised. Acquisition may be a means of appeasing the ego of the chairman, who adopts a deliberate strategy of growth by this means. Stock markets and financial press commentators are often impressed with this, particularly if accompanied by apparently rising profits. Stock markets and the financial press, being predominantly male institutions, are usually impressed with size and power, rather than seeing them as potential hazards. For rapid growth in a pattern of acquisitions creates not only the opportunity, but not infrequently the need, for creative accounting to demonstrate continuing profits increases and sustain the vital share price, which is usually used as the means to pay for further companies by the issuing of more shares (Smith 1992).

While motivation has implications for the consequences of takeover – the Anglo-American company Hanson, for example, showed considerable skill in the 1980s and 1990s in buying up increasingly large companies and then selling-on the less profitable parts and retaining the more profitable, so avoiding the risks of succumbing to the ever diversifying responsibilities of an increasingly aimless conglomerate as some of its imitators did – the outcomes are always contingent in two important respects. First, no one really knows before the merger what the costs, human and material, will be in unifying the new entity, or whether it will ever create a successful single, new corporate culture and strategy, let alone what skeletons may clatter out when cupboards are opened by the new owners. Secondly, ownership gives almost absolute discretion, and new owners may go back on undertakings given during negotiations once they take control, either because that was their original intention, or because things do not look the same after the takeover as before it, including changes in the external situation as regards markets, interest rates, political changes and so on.

Takeovers and mergers are hence similar in many ways to sexual relations: they may involve rape and violence as well as gentle wooing; the union which follows may be one which is very temporary or enduring, and if enduring, harmonious and successful, or discordant and troublesome. The major difference is that where sexual relations usually involve two individuals, takeovers involve very few individuals taking actions involving very large numbers of others. They are hence clearly fraught with risk, and, since they are an alternative to internally generated growth, could arguably be subject to restraints which presumed against them rather than, as in the Anglo-Saxon world, an ideological presumption that they reflect the workings of the market, and hence that matters can be left to resolve themselves. The central argument here is that takeovers create a market for effective management of firms and that shareholders are entitled to seek the best return on their investments by using takeover offers as a means to installing new management to revitalise the company. It was this argument that drove the celebrated contested bid for the major British liquor company Distillers in the 1980s with the eventually successful bidders Guinness claiming that they alone could revive Distillers' ailing spirits (Kochan and Pym 1987). It was also the argument proselytised with manic zeal in the film *Wall Street* by Gordon Gekko (Michael Douglas), only in the end for the outcome to involve wage-cuts and job-losses. If this argument has a significant amount of truth in it, there may nonetheless be grounds for defending takeovers as a general and largely unrestricted practice, and seeing the unattractive consequences and some of the unattractive operators as a cost that the system must bear if markets are to be able to function to exercise discipline to require companies to be efficient.

A difficulty that arises here, however, is that takeovers rely on financing and hence on periods when the costs of financing are relatively cheap, and of course that sources of finance are available, often but not always, borrowed. The danger is that what begins as a series of well-judged initiatives to pick off poorly performing firms and restructure them gradually builds into a speculative boom. This is particularly likely once operators arrive who are essentially dealers in companies, buying and selling them for short-term profit, whether as unchanged going concerns, or as 'unbundled' elements whose parts are worth more than the conglomerate, or as stripped-out assets, particularly real property, or even as vehicles for tax-savings. Once this process begins, the market shifts from being concerned with 'fundamentals' – whether a firm is well and profitably run – to a concern with whether a profit can be made by doing deals with it. Here the involvement of share prices becomes of leading importance, with the value of target companies rising rapidly as expectations rise of a bid. This process is potentiated by the activities of arbitrageurs who try to work out which companies are likely targets and buy up a strategic block of shares in advance, in the expectation of making a handsome profit. When the process is advanced this speculation in itself can put a company 'in play'. By the end of this mounting frenzy, most medium and large companies are compelled to take steps to boost dividends and hence share-prices to avoid being takeover targets, and their assets and energies are diverted from the long-term development of the company (Bruck 1988). The atmosphere generated, which involves a kind of megalomania among the speculators, is vividly portrayed as it occurred in Wall Street in the 1980s in Michael Lewis's *Liar's Poker* and in Tom Wolfe's *Bonfire of the Vanities*.

As the Trade and Industry Select Committee (1991) pointed out, British companies spent 16 per cent on takeovers of the amount that they spent on capital investment in 1990, but in the preceding four years of the takeover boom this figure was 50–60 per cent. As Keynes remarked long ago, 'speculators may do no harm as bubbles in a steady stream of enterprise. But the position is serious when enterprise becomes the bubble in a whirlpool of speculation. When the capital development of the country becomes a by-product of the activities of a casino, the job is likely to be ill-done' (Keynes 1936, cited in Fairburn and Kay in Hughes 1989, p. 98).

Although the Trade and Industry Select Committee was told by an academic researcher, J. Kay, that 'there is no evidence that take over activity has had beneficial effects on the economy of any magnitude in any way commensurate with the importance which appears to be attached to it in corporate strategy' (section 67), such a detailed appraisal was not supported by prevailing sentiment. The DTI said that 'the availability of the take over mechanism on the whole is a good thing and a stimulus to good management. The Association of British Insurers told us that it acts as a discipline to ensure that company management are kept on their toes.' The CBI added that 'the threat of take over can actually improve business performance'. The Vice Chairman of Hanson said that 'it is a great spur to management. It requires management to address the interests of shareholders, the owners of the business' (section 71). The Committee concluded that this was likely to contribute to over-concern with short-term profitability rather than long-term sustained development, though it noted with interest the severe difficulties into which the Dutch electrical giant Phillips had fallen, and speculated that remedial action might have been taken earlier had the company not been protected from takeover by Dutch regulation.

The differences between cases and the effect of booms make clear judgements difficult. It is worth citing Hughes's conclusions on the basis of a careful review.

> Except at the height of the boom (take over) discipline appears constrained to the middle size range of companies. Moreover the accepted favourable route to avoid nemesis is to grow bigger and seek more stable profits in the short term, rather than to go for higher medium term profitability. The disciplinarians are bigger and faster growing, but not on average more profitable, and their share holders gain little or even lose as a result of their company's acquisitions. The share holders of acquired companies on the other hand make windfall gains that on average have no counterpart in improved resource use or organic profitabilty . . . . The neutral net effects on stock holder welfare would be more consistent with the observed average post-merger performance effects. All this evidence seems at least as

> consistent with an inducement to empire building by growth minded managers as with discipline in the stock holders' interests.
>
> (Fairburn and Kay 1989, p. 96)

There have been two major takeover booms since 1945, one in the 1980s and one in the latter 1960s which, although its excesses attracted criticism and, in Britain at least, was associated with a commercial property boom that led to a serious crisis among so-called secondary banks (Clarke 1981), as mentioned above it was also seen by a Labour government as a necessary means of restructuring Britain's industry to become more competitive internationally. The outcome of the 1980s boom was, as we have seen, more equivocal, despite the existence of market-oriented conservative administrations throughout and beyond it. Although no substantial restraints were introduced, it did contribute to corporate governance the role and responsibility of directors of companies being put onto the political agenda. The excesses of the period alarmed the government sufficiently in the immediate context of its intervention to modernise and regulate the entire financial sector through the Financial Services Act 1986 to stimulate it to get the newly created Serious Fraud Office to pursue delinquents, notably those in the Guinness and Blue Arrow cases. The outcome was a series of expensive disasters for the prosecutorial strategy (Clarke 1998b), while at the same time little was done at a regulatory level and, as is so often the case with political priorities, other concerns took centre-stage as the boom ended.

The 1980s boom in America is ably analysed by Blair and her colleagues (1993). They place considerable emphasis on the origins of the boom in a conjunction of factors. In particular,

> real interest rates on government securities and other safe financial instruments which had hovered between 0 and 2% since the mid 1950s, rose to 6–8% in the mid 1980s driving up the returns investors required for risky investments such as corporate stocks. Meanwhile the returns to capital earned by firms in many industries were low during the 1970s and declined even further in the recession of 1981–2. Thus in the late 1970s and early 1980s important goals of publicly traded corporations – growth, competitiveness, good jobs with good pay and benefits and high returns to investors – began to come into direct conflict for the first time since the end of World War II (p. 3).

At the same time the 1980s saw the rise to power of the new right, with the celebration of markets and an emphasis on the rights of property.

The demand for better returns for shareholders and improved performance by industry proved very attractive, especially when takeovers began to generate greatly increased sophistication and energy and, as Kay pointed out, to produce considerable windfall gains for the shareholders of lack-lustre large companies.

The problem was that target firms learned to protect themselves by buying up their own shares and, in the extreme case of the leveraged buy-out, borrowing aggressively to take the company out of the market entirely. The winners were increasingly the speculators and the brokers and advisers who arranged or helped to resist the deals. Increasing numbers of companies ended up burdened with debt, and although deals in the earlier part of the boom may have had some justification, they latterly became speculative and overall the outcome was 'reduced capital spending and slower rates of growth for the firms involved' (p. 12).

If ideological zeal was potent on the side of the deal-makers and takeover companies, it was also significant in preventing any restraint on predatory takeovers as the boom got under way:

> The Securities and Exchange Commission was ideologically committed to letting the market take its course and the Supreme Court struck down crucial anti-take over statutes. Business leaders then carried their complaints to Congress, which held a lot of hearings but refused to do much. Business leaders then turned to the states, who proved more sympathetic. By the end of the 1980s more than 40 states had passed new anti-take over laws.... Statutes passed in 29 states specifically authorised corporate directors to consider the interests of constituents other than their share holders in deciding about take over offers or setting their corporate policies have, for now at least, tilted the scales of corporate governance back towards managerial autonomy (p. 14).

To British eyes this was just another example of the American habit of resort to litigation and legislation to solve problems by taking things to extremes. Though the British takeover boom in the 1980s had its excesses, they were not as great as in America. Takeovers were – and are, regulated by a curiously successful hangover from an earlier period in which banking and finance were entirely managed in an informal private manner, which was largely ended when formal state supervision was imposed in the 1986 Financial Services Act, subsequently amended in practice (Clarke 1986, 1998a). This was recently revised with the constitution of the single-tier Financial Services Authority, which brings Britain closer to the American model, with the powerful Securities and Exchange Commission at its centre (Moran 1994; Shapiro 1984). While the merits of the individual bids are, as mentioned above, evaluated by the OFT and MMC, with a final decision by the minister, the procedure by which takeover bids are launched, particularly in contested and hostile cases, is supervised by the City Panel on Takeovers and Mergers. This group of practitioners seconded into the informal body, with its office at the top of the Stock Exchange, grew out of earlier efforts by the Bank of England and the Stock Exchange to prevent oppressive and unfair conduct which were largely unsuccessful (Rider 1978). After the constitution of the panel in 1968, however, its practical powers and effectiveness gradually grew. It developed a rule-book on the conduct of takeovers with, for example, thresholds for disclosing a stakeholding and for being required to make an offer for the entire company. In subsequent years it was blooded in a number of encounters with doubtful practitioners and almost invariably won through in the end and had its rulings respected, despite the fact that it is an informal body with no legal status. It has hence always been vulnerable to challenge in the courts to the effect of: 'Who are these people? They have no right to tell me what to do.' Such a challenge, at least of serious proportions has, however, never materialised in fact, no doubt because the Panel has shown itself to be a judicious private regulator whose views and practices are respected, in part also because it is preferred to state regulation, which is seen as more rigid, and in part because it has been firmly backed by support from powerful city institutions including the Stock Exchange and leading merchant banks, whose members provide its membership for periods of service. Despite these private regulators hence coming from regulated institutions, besides having traditional city backgrounds, a degree of impartiality has prevailed in its supervision of 6000 takeovers: 'We banish from our minds any thought as to who's going to win and who's going to lose .... Our main purpose is to ensure fair treatment for investors in the target company and fairness between competing bidders. The circumstances of a bid are always unique. We must apply the code according to the spirit not just the letter' (A. Defriez, Panel Director-General, *The Times*, 17 January 1997). The major hazard on the panel's horizon in the later 1990s, besides a potential legal challenge by an individual firm, lay in a coming European directive which would require it to come clearly under the law. There was a wide, if reluctant, expectation that this would eventually happen.

In the meantime, the gap that both the British and American systems of takeover regulations suffered from was any basis for the separation of individual bids from the collective phenomenon of a boom. The former are regulated, but there is no intervention on the latter and it is booms, with their speculative element, that are really destructive. Here, curiously, in both countries there was a retrospective understanding that this could be so, a clear understanding by academic and other commentators of the irrational elements of the boom, but no attempt to act to prevent them, largely, it seems, because of a reluctance to curtail such a magnificent example of a rampantly free market.

3
The Professions

The importance of the professions in relation to regulation is that they are an example of established and comprehensive private regulation in certain kinds of work. Nor are they mere exceptions or eccentricities: the aspiration to professional status and the control over work which it involves is a powerful one that has stimulated efforts to achieve it throughout the nineteenth and twentieth centuries. Although the ancient professions, notably law, the clergy and universities, have their origins in medieval times, it was only in later periods that the professions took on their modern form, with medicine in particular, arguably the most powerful of all, only succeeding in the late-nineteenth and twentieth centuries.

The professions have struck a kind of bargain with society. In return for the dedication of professional workers to a particular area of expertise and the cultivation of competence in it, both by extensive training before practising and by continuing effort and training in practice, and for a commitment to deliver a service to the public rather than exploiting their expertise for however much reward they can obtain, professions are granted a high degree of autonomy and a good deal of respect and deference. Autonomy is manifested in control over recruitment, so enabling the profession to ration the supply of expertise to balance with demand for it, and control over training and accreditation so that only professional bodies can license the work in question and no one else can do the work, or call themselves doctors, lawyers, and so on. Autonomy is also manifested in the disciplining of members of the profession by the profession itself, both for active misconduct against clients and other members of the profession, and for negligence and incompetence. One outcome of these arrangements is substantial control over rates of pay, with professions able to impose common scales of fees and charges on the public so as to secure a minimum level of earnings for most members. Much higher levels of earnings are likely to be open to some, because as professions develop, they specialise and some specialist skills will be in exceptional demand. Further, it is accepted that while a profession insists on minimum standards of competence, it benefits as a whole from the exceptional achievements of the gifted minority, both as exemplars and for their contribution to the development of professional skills and knowledge, and accordingly they may command higher fees.

The privileges of autonomy are not granted indiscriminately and in principle two conditions have to be met: the aspirant profession has to show that it has the expertise both in theoretical understanding and in effective practical application to be able to offer a competent service to clients; and that the area of work in question is of sufficient importance to make the achievement of minimum standards essential and for a free market in expertise to be banned. Medicine provides a classic example of this. In the early nineteenth century modern science-based medicine had to compete with established theoretical medicine, which had its origins in the speculations and systematisation as well as experience of ancient Greece, Rome and Egypt, with theories further developed by intellectuals in the Middle Ages on the one hand, and with folk medicine, based largely on oral culture and experience and the use of drugs and herbs on the other. Both attempted to deal with a vital matter, not health as we now experience it as a positive state of well-being, but serious illnesses and accidents, as well as childbirth, all of which often ended in death. Once modern medicine learned how to intervene effectively to cut death rates, for example by vaccination, by understanding that infection could be limited by better hygiene, both in society and especially in surgical invasion, and through a better understanding of anatomy and physiology once operations could be carried out under anaesthetic, modern medicine was in a position to show that it could get results and that its explanations worked. Once it was perceived that not only could it get results, but that it could go on improving, its success as a profession was guaranteed. There is, at any rate for most of us, not much that is more important than staying alive, and it is plain enough that the ministrations of amateurs can be very dangerous.

The success of medicine serves to remind us of the eclipse of another profession. Before economic success and modern medicine increased life-expectancies, death at all ages was a constant possibility, especially from infectious diseases. Not surprisingly, there was a lively concern with what happened afterwards. Fears were ministered to by the church, whose chief function was to assist people in ending up in Heaven rather than Hell. In the absence of an established material (or science-based) understanding of the world and the wider universe, the church offered an account. Its position was hence powerful economically and politically as well as socially and morally. With the rise of science – and Darwin agonised for years before publishing *On The Origin of Species* because he was aware of what its impact would be on religion – and the success of medicine, industrial economies, democracy and the idea of progress, religion became less critical, the prestige of the clergy waned, church attendance fell and the incomes of the clergy have fallen so low today as to put some barely above the poverty level, a far cry from the gentlemanly comfort they enjoyed in earlier centuries. The demise of the church left a gap, however. It was a source of solace to the anguished and distressed as well as a moral guide, both through its formal rituals and public prayers and through the personal ministry of the clergy. Medicine, though it successfully colonised mental disorder through psychiatry, has not developed anything like the expertise on the mental and emotional side that it has on the physical, and psychiatry has effectively been confined to the care and management of the most severe cases, often by physical intervention (drugs, electro-convulsive therapy, etc.). This has left a large constituency, especially in a physically healthier, more educated, long-lived and more affluent and more demanding public with no profession to turn to in times of extreme emotional turmoil and distress. These needs are presently being serviced by a constantly diversifying number of therapies both physical (massage, acupuncture, etc.) and verbal (psychotherapy). There is no doubt that expertise exists and that some techniques are effective in some ways, but the field as a whole is still inchoate. Although professional bodies exist for the large variety of different techniques there has been little consolidation, and hence there is little immediate prospect of professionalisation, though in time the damage that can be done by misuse of some of the techniques is likely to promote change.

The reader will have no doubt complained by now that this is a rather idealistic view of the professions. Clearly they do not work in quite the way described above: what about those fat-cat lawyers and are not the big accounting practices more like multinational corporations than professional practices? Two matters exist in tension which account for a good deal of this. Professions are a form of work. They appeal to many people because they offer the prospect of doing a job well and of providing a vital service. In the world in which we live, a capitalist industrialised democracy, everyone has to seek work, either as self-employed or employed, in order to live. Welfare dependency may be substantial, but it is not acceptable in any sense of that term.

Adults in all societies work and through their work make a contribution to the lives of others, and keep the economy and the society as a whole functioning. Work provides a profound sense of reward and legitimacy to those who perform it in reasonable circumstances. It provides dignity, self-respect and a sense that, since you contribute, you have rights to participate in and take from society. The sense of service to others and the satisfaction in developing and applying a socially beneficial skill is profoundly human and profoundly social. It is these satisfactions that the professions offer, yet they are seen as a special and privileged kind of work which is exempted from the normal pressures of the market. Professions certainly operate restrictive trade practices: fee scales, bans on touting for business and advertising and on bad-mouthing professional colleagues all contribute to an environment where professions were characterised by G. B. Shaw as a 'conspiracy against the laity' with their aura of cultivated mystique and their refusal to contemplate negligence, incompetence or worse in fellow members of the profession. Try finding a lawyer willing to represent you in a negligence case against another lawyer, or a doctor willing to give evidence of malpractice by a colleague. We shall return to these problematic features of modern professions below.

For the moment the important contrast is between professional work and that which the rest of us do. A distinctive feature of that work is that it is governed by the market, and for many by a labour market. Thus the employee is subject to industrial discipline and must do what he or she is required on pain of dismissal. This may not leave much room for the development of excellence or recognition of it. The self-employed worker is at the mercy of the market and must earn money where he or she can. Businesses may, as we saw in the last chapter, very often attempt to restrain the consequences of competition and stabilise their markets and, in so doing, enable themselves to offer a reliable and sound level of service at a reasonable rate of return. Professions, in other words, address precisely the same problem as occupations as businesses do as industries: managing the market. As Krause (1996) has pointed out, they have their origins in the medieval craftsmen's guilds which similarly regulated training, prices, working hours, materials, standards of products and other matters in order to allow sound quality for reasonable rewards. Where they became powerful, however, they not surprisingly began to abuse their power. Senior members of guilds became very wealthy and guilds played a powerful role in the political as well as economic life of cities. The guilds were swept away by the capitalist industrial economy, which on the one hand outflanked their handicraft skills with machinery, and on the other introduced the discipline of market competition. The immediate consequence was the dependence of former handicraft workers upon employment in the new factories and their destitution in the slumps which crises of over-production regularly brought about.

The profession in the modern sense of the term is hence a reaction to the alienating and destructive features of capitalism upon work. This is not to say that preceding systems dependent upon slavery, serfdom and peasantry were models of perfection. It is to say, as Marx (1964) pointed out in his reflections on the early phases of industrialisation in Britain, that human beings recognise what work can and should consist in. Marx's proletariat was, however, in no condition to achieve much in this direction and Marx did not anticipate that it would, this side of the revolution. It was another group that proved more capable of resisting and as industrialisation progressed took advantage of growing opportunities.

Industrialisation progressed on the basis of constant technical innovation which, for the first time in history, produced cumulative rises in income and wealth and cumulative social and political change. It also introduced the very notion of progress as something to be aimed at in all spheres, first material production and wealth, and then social and moral. As industrial production became more complex, enterprises grew larger and they began to require more and more specialised and administrative staff. As society grew larger, more complex and more democratic, it required increasing intervention by a range of specialists. Thus we have alongside those professions already established and establishing rapidly, which service all or most citizens at some time in their lives, largely on a personal basis – law, medicine, the church and universities – those which service business or well-respected clients – engineers of all varieties, such as surveyors, town planners and accountants, for example.

As Perkin (1989) has amply documented, this led to considerable deference and respect for expertise which, it seemed, had been responsible for the great technical and scientific achievements which had enabled industrial growth. By the latter part of the nineteenth century the professions had come to offer the middle classes a gentlemanly alternative to the rigours of the market. Provided one could afford the education and training, one could commit oneself to a life of professional service in the reasonable expectation of a certain social respect and a reasonably comfortable income. As the economic and military capacity of Britain translated itself into a moral superiority, this professional service ideal spread, with the reform of the military and an end to the sale of commissions and the development of a professional officer class; similar reforms in the civil service, and the development of a large imperial service dedicated to bringing British justice and civilisation to the foreign possessions, took place along the same lines. Respect for expertise was further developed as class conflict grew in the early years of the twentieth century and threatened to overwhelm Europe. The response of the non-revolutionary left was the constitutionalisation of social and economic planning and progress, with the management of society increasingly given over to a professional and intellectual elite, a view most clearly expressed by the Fabian Society, allied to the Labour Party, and by its leading activists Sydney and Beatrice Webb. Such sentiments were supported by the recognition of the need to mobilise the entire society and economy of Britain in the First World War, despite its initial reliance on volunteers, and then the gradual acceptance of the necessity for active economic management in both Britain and America in the interwar depression.

The first half of the twentieth century hence became a golden age for the professions, with one group after another attempting to achieve formal recognition, state registration and control over its market by forming professional bodies, demonstrating expertise and attempting to drive out charlatans. The process is habitually understood by the profession in retrospect as one of heroic achievement by dedicated groups and frequently exceptional individuals acting as beacons to others and assisting in gaining public recognition. The other side to this process is political campaigning. Once the possibility of successive occupations achieving the coveted professional status became established, everyone began to jump on the bandwagon: not just doctors but nurses, physiotherapists and dentists, not just academics, but teachers and librarians; not just surveyors with their military and engineering origins, but land agents, auctioneers, town-planners and even estate agents (Clarke *et al*. 1994).

The progress achieved by different groups hence reflects not just the fundamentals of the bargain with society outlined earlier: the servicing of a vital function on the basis of proven expertise. It also reflects the outcome of political campaigning, often over an extended period. This implies that the outcome may not reflect the fundamental justice of an occupation's case and that outcomes may be different in different societies. Krause analyses the structure of the leading professions in five industrialised societies over time, and shows how the strength and nature of the state and the varying demands of capital produced patterns which not only affected the degree of autonomy enjoyed by given professions, but the way in which professions are structured – Britain, for example, has a distinctive system of lawyering, with barristers serving the higher courts and the judiciary, and the more numerous solicitors the lower courts and the general public and business as clients; France has a special occupation of *notaire* established by a powerful central state to perform certain jobs for it, for example the transfer of real property.

The idea of the 'professionalisation of everyone' (Willensky 1964) and the possibility that some occupations might succeed by good fortune and political skill rather than merit sowed the seeds of doubt about the claims of professionalism. The professions are exclusive social groups and generate powerful cultures which tend to be lofty where they do not actually denigrate the laity. There is a sense that anyone who is not a member fundamentally lacks understanding of the world, which is of course perceived through the professional culture. No one is more flatulently pompous than a professional in full flow on the merits of his profession and its attendant expertise. In a democracy with rights and confidence gradually extending throughout the population this was dangerous.

In consequence, many aspirant occupations have never achieved full professional status – teachers, social workers, nurses and librarians are examples of what have come to be called semi-professions (Etzioni 1969). Sometimes this was the result of the response of the established professions: doctors, for example, arguably maintain nurses (and other occupations) in a subordinate service role to shore up their own status. Sheer numbers are significant – even once teaching became an all-graduate profession in Britain in the 1970s, did not the very number of teachers devalue the degree as a truly distinctive qualification? A good many teachers evidently believed so and sought to obtain Master's degrees in more specialised subjects to promote their career prospects. Other occupations were compromised by being unable to distance themselves from the market. Thus estate agents, despite constant attempts to form professional bodies and seek chartered status, and a lively awareness that abuses and sharp practices needed to be outlawed to protect the public, were constantly undermined by their business involvement. Since they take commissions on property sales, they have an interest in achieving the sale as well as does the client, and since there is no fee without a sale this interest may not always extend to getting the best price. Further, without professional control of the market, every property boom brings a new clutch of novice estate agents, who survive by offering a service at cut rates. Although local cartels are a common reaction to the problems of competition among established agents, with the object of enabling them to devote adequate time to each client's property to provide professional service, newcomers will naturally refuse to participate. Since customers' leading concern is a sale in short order and there is entrenched scepticism as to the services estate agents perform, there is a constant divide among estate agents between those who emphasise the business and deal-making side of their work and those who emphasise the client care and professional side (Clarke *et al*. 1994).

In other cases, by contrast, demand for professional expertise by society and/or by the state can be powerful and promote its development regardless of various inadequacies by practitioners along the way. Accountancy is a leading example of this, with the creation of limited-liability joint stock companies in the mid-nineteenth century creating an evident need for shareholders, now very diversified and distant from the management of the company in which they had invested, to have some account of how their money was being managed. The company audit seemed to provide this evidence, but this immediately raised the question of the competence and independence of auditors. We shall return to this at length later. For the moment the point is that a demand was created which then developed further as accounting became part of the essential means of managing the ever-growing corporation and that audit could have been undertaken by the state or by state authorised officials, a specialised group of accountants, or by an accounting profession. The outcome was slightly different in different societies and over time (Krause 1996; Roslender 1992).

It was the period after 1945 that brought the golden age of professions to a close, however, with the same series of developments outlined in Chapter 1 having a distinctive impact on the professions, their status and especially their right of self-regulation. The first change came with the postwar settlement and the establishment of the welfare state, though its implications were scarcely recognised. One consequence of it was that professional services, notably law, medicine and education, higher and lower, were provided on a much wider basis to the population, subsidised and sometimes wholly paid for by the state. Professions, notably medicine, were not entirely willing partners at first and reluctant to give up their freedom to charge fees as they saw fit and to provide a *pro bono* service to the poor. General provision, with state funding, implied a degree of state control. Aneurin Bevan's solution to the resistance of consultant doctors was, in his phrase, to 'stuff their mouths with gold'. State subsidy through the Legal Aid fund, the universal provision of free secondary education, of state support for scholarships to grammar schools and state funding for grants for all entrants to higher education, with no fees charged, constituted a powerful endorsement of the professions involved, who were left undisturbed in the management and delivery of services. The change, however, was that the state had now become a stakeholder in the professions.

For a time all was calm, as the postwar boom sustained high tax revenues and the expansion of opportunities and the changing structure of the economy promoted increasing affluence and social mobility, and better access to education increased people's understanding and self-confidence. Affluence brought with it consumerism, however, which began to take off just as the boom was coming to an end in the 1960s. Initially consumerism was directed at the expensive and more complex consumer goods now seen as desirable and affordable, often on extended credit – cars, washing machines, televisions, and so on. Expectations as to quality and reliability of service increased, and demands for guarantees and rights of redress became more insistent. With the consumer becoming a wide political constituency and with consumer demand and self-confidence increasingly driving the economy, these demands were gradually acceded to, both in consumer legislation and in industry complaints and redress schemes, often mediated in Britain by the Office of Fair Trading, as we saw in the last chapter, and by individual company schemes. As time went on, consumer expectations as to the performance of physical goods extended to services, with banks, for example, coming under increasing pressure to be more open and customer-friendly rather than, as they had traditionally done, to cultivate an atmosphere in which the ordinary (as opposed to the wealthy) customer was treated as though the very opening and maintenance of an account was a great favour, and as for asking for an overdraft.... The positive side of a similarly paternalistic culture has been presented in respect of building societies as mortgage-lenders. It had its irritating and patronising aspect too and it was partly for this reason that the shift to selling money in the 1980s was so rapid. And from services it was but a small step for consumerism to move to a critique of the professions.

Criticism of expertise and of automatic deference to it took root in the intellectual and cultural ferment of the 1960s and early 1970s, with professions increasingly being seen as overweeningly arrogant. While Ronald Laing (1960) bitterly criticised psychiatry for using physical means to attempt to control schizophrenia, which he regarded as an emotional disorder with its origins in family life, Ivan Illich (1976) produced a comprehensive indictment of medicine, which he maintained caused as much malady as it resolved and fostered an obsessive concern with health and fear of death. Alternative and complementary medicine began to flourish in the counter-culture. Town-planners were attacked, both by academic researchers and by the populations affected by their urban renovations, as the urban renewal programmes run by governments to eliminate old, poor quality housing reached a peak of activity in this period. Lawyers began to be bypassed by business in favour of arbitration panels run by people with business backgrounds and community law centres sprang up, some funded by government in Britain, to service legal needs which the profession largely neglected, such as landlord-and-tenant disputes. The women's movement added its voice to criticism of professions as bastions of male power, which neglected women's interests and were reluctant to admit women as members. The anti-authoritarian tone of the period naturally lent itself to a critique of the power, privileges and moral and intellectual presumptions of the professions.

It was the advent of the new right in the 1980s, however, which transformed scepticism into attack. The professions were readily identified as restraints on the free market and their privileges systematically though not entirely dismantled. Scale fees were banned, advertising was to be permitted and competition vigorously encouraged. With the introduction of accounting techniques into governments and the state, on which more below, those professions funded or aided by the state began to experience direct pressures to reduce costs and improve performance. Thus the explicit policy of Conservative administrations in Britain was to require universities to take on more students while maintaining funding at the same level. Simultaneously state control over the funding process, previously mediated by an effective buffer agency, was considerably tightened and performance evaluation procedures were set up to assess where funding should go for research, followed by formal reviews of teaching quality. Solicitors were subject to marked increases in competition as conveyancing of property became open to specialised licensed conveyancers, who could survive only by undercutting solicitors, who in provincial practices had relied substantially upon conveyancing in the past. Doctors were subject to the creation of quasi-market conditions in hospitals, with an emphasis upon the costing of everything, and a greater throughput of patients with short hospital-stays, and general practitioners were given incentives to become fund-holders and manage their own budgets, as were schools.

The effect of these pressures was to move the professions sharply in the direction of business, and to greatly increase their concern with costs, self-presentation, efficiency and profit. Service shifted from that which reflected professional judgement to that which was calculated to impress customers. The change was evident in a number of ways. Practices became larger in order to reduce the proportion of costs in overheads, sole practices declined, specialisation increased, both within practices and between them, as merely providing a general service to the public became less viable and competition for a niche more necessary. Office equipment was expanded greatly in order to bear down on staffing costs and full professionals shifted more of the burden of routine work to administrative and secretarial staff and to para-professionals – solicitors notably expanded the role of legal executives, universities the contribution to teaching of researchers and fixed-term contract staff, for example. Accounting, budgeting and business plans became central matters in professional practice rather than beneath the dignity of august senior figures to consider too often. The market was plainly being used to encroach on private regulation with the principal object of forcing down fees and charges and reducing the market privileges of the professions.

One area did not, however, come under serious pressure until the 1990s, and when it did it caused considerable trouble. The heart of the professions' claim to autonomy lies in the capacity to deliver an expert service. Professions had achieved control of their work by claiming that they would accept responsibility for securing minimum standards. This was to be achieved by admission and training procedures, which include a period of practical training under direct supervision by accredited practising professionals as well as theoretical education. If established professions were to become open to serious criticism of their training they would be in danger of outright derecognition as inadequate, and this in practice has not happened. The new area of vulnerability is that of ensuring a uniform standard of competence, diligence and good conduct. In recent years consumerist pressure for effective complaints procedures against professionals has become more insistent, and in doing so come up against considerable opposition. Thus, for example, attempts to establish an Institute of Learning and Teaching to maintain and accredit the teaching of academics in Britain was responded to as an affront. 'It reads like a government agency pretending to be a professional association', remarked one. The Committee of Vice Chancellors and Principals accepted that there was a real job to be done in persuading academics to support the idea. Comparison with the compulsory training of school teachers was seen negatively, since academics identify with their discipline – as biologists or historians – and as researchers in it first and as teachers second (*Times Higher Education Supplement*, 22 May 1998).

Lawyers were even more dismissive. Research on solicitors' responses to a new requirement by the Law Society that all practices have a complaints procedure concluded that many rejected the idea, because they believed that it is wholly illegitimate for clients to complain about service quality. 'There are still many solicitors who believe that "because I'm a qualified solicitor I know best" ' (*The Times*, 2 May 1998). Three-quarters of clients in the study were dissatisfied with the way their complaints were handled. Despite several changes in its name and organisation, the solicitors' central complaints organisation similarly failed to carry public support and was subject to a ringing condemnation by the Consumers' Association for its delays and ineffectiveness. So disruptive an issue did this and other matters become that an iconoclastic president of the Law Society was elected in the mid-1990s, but even he was unable to achieve decisive change. While welcoming the appointment in 1997 of an independent ombudsman and former chief executive of the Association of Citizens' Advice Bureaux, he pointed out that

> in a succession of annual reports the Society's complaints bureau had presented itself as a model of efficiency and fairness with criticism dismissed as ill-informed or malicious. The flow of glad tidings culminated in the Solicitors' Complaints Bureau's 19 July 1996 press release. This claimed the quality of the bureau's decision making was demonstrated by an almost faultless record of appeals. The re-organisation carried out in 1991 had resulted in a system that could be regarded as the Rolls Royce of decision making. We were told that in an external quality audit in May 1995 a statistical sample of files taken at random disclosed no delay or error. In the face of such claims why was there a second re-organisation in 5 years? The reality was that the outside world's perception of the SCB was so negative that the Law Society concluded that nothing less than a relaunch under a new identity would quell the current criticism. As it turned out the latest re-organisation was purely cosmetic. Meanwhile such evidence as there is suggests that the old habits and practices

> of the SCB continue mostly unchanged. What is different is that the (new) Office for the Supervision of Solicitors has become yet another outpost of management .... What it lacks in performance it makes up in presentation. It has its business plan and its key tasks. Complainants are customers. It has its mission statement, its masthead slogan. But the same impossible caseloads continue to be handled by the same personnel, with the same levels of delay and complaints of dissatisfaction.
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> (M. Mears, *The Times*, 16 September 1997)

Meanwhile barristers confronted complaints that not only were some vastly overpaid, but that some greatly inflated their claims for fees, which were routinely cut by half or more by the court taxing master. Considerable resistance was mounted to the idea that a complaints procedure should be established for barristers, enabling their lay clients to complain about inadequate and negligent standards of service, despite a recommendation by a distinguished Bar Council chairman.

It was in the medical procession, however, that a crisis over professional competence arose. The high level of mortality and brain-damage among children operated on by two cardiac surgeons at Bristol Royal Infirmary – 29 of 53 died and 4 were brain-damaged between 1988 and 1995 – caused a convulsion in the medical profession. An anaesthetist who had attempted to alert the profession and had collected evidence was reprimanded by one of the doctors and could get no one to take any action, and eventually left the hospital in despair. The affair had all the ingredients for a sensational impact. The patients were children, usually small, suffering from congenital heart defects, which in the past would have proved fatal in a limited period. Modern surgery, however, makes these conditions remediable, albeit with some risk. The scandal hence turned, first on the much greater mortality rate at Bristol than the national average at other children's heart centres recognised by the NHS as Bristol was; and secondly on the failure of those involved, including the head of the hospital trust, to take action. Of course each case is different, and the difficulties and risks posed by some are much greater than in others. For this reason it is not straightforward to compare outcomes. Nonetheless comparisons can be made allowing for these problems, and the GMC Committee found that one doctor had ignored four warnings that his work was below standard. He and the director of the trust were ordered to be struck off. More remarkably the Secretary of State for Health responded immediately by saying that in his view all three should have been struck off, a very rare if not unprecedented intervention by a minister in a matter involving clinical judgement. Following the replacement of the surgeons by a new appointment, survival rates for child cardiac surgery at Bristol rose to above average.

Most revealing of all was the response of the medical profession. The chairman of the BMA Consultants and Specialists Committee admitted that 'we simply do not know and cannot compare our work with our peers. People find it astonishing that we don't have this data.... An individual surgeon can work out how many patients die within thirty days of an operation, but there is nothing to compare it with. And if you have nothing to compare it with, it means nothing' (*The Times*, 5 June 1998). The reason for this lack of standardised comparative outcome data is the strength of professional reliance upon individual professional judgement, diligence and conscience. The notion of a standard success rate implies the possibility that some members of the profession might at times be falling below standards and others not notice or refuse to act. As with barristers and solicitors, this was held by doctors to be unthinkable, and of course offensive.

What these changes heralded was hence the reform of accountability for professionals, even in the conduct of their professional work, with redress potentially available to the lay client via an independent procedure, although one in which there would necessarily need to be a professional input. Whether the final bastions of professional autonomy had been breached remained to be seen, but there was no mistaking the penetrating success of the attacks.

The position of the professions as autonomous bodies with substantial private control over their work and the market for it has hence changed significantly in the past half-century. They are subject to much less deference and more competition, require much more attention to efficiency and good business practice and are becoming more accountable. We have concentrated implicitly upon the established and powerful professions as examples of the way in which their power has weakened. What, however, of the more recent professions and especially those still aspiring to professional status? Is there still room for new professions and if so on what terms? A brief account of the experience of four professions and would-be professions illustrates the difficulties occupations have had in professionalising on the old model of forming professional bodies and seeking state registration, but at the same time the increasingly important role of the state in promoting the development of professionalisation where a need for it is perceived.

Achieving and maintaining professional status at the end of the century

Loss adjusters, who investigate and evaluate claims on behalf of insurers, provide an example of a profession which succeeded on the old model, achieving chartered status in 1948. Adjusting in Britain is highly independent in comparison to other countries, being almost entirely undertaken by independent practitioners. In America, adjusters are both employees of insurance firms and in independent practice. In France the bias is more to internal employees. Adjusting is a specialised service entirely dependent upon the insurers, who plainly will only continue to use it if it is cheaper and more efficient than undertaking claims investigation themselves. There are advantages to insurers, however, in having an independent report on a claim since there is a clear conflict of interest between the claimant, who will want the maximum payout, and the insurer, who will want the minimum. In practice, especially with larger claims, this involves a process of negotiation in which the adjuster can act as a mediator. Indeed until recently adjusters, although instructed and paid for by insurers, were required by their professional code to act and to be seen to act impartially. Recent developments have seen the recognition that they are inevitably the insurers' agent and the experiment by some adjusters with offering to represent claimants as assessors (Clarke 1989, 1990, 1996; Cato-Carter 1984; Sharp 1988; Ross 1970). Although adjusters have come under considerable financial pressure in the past two decades as competition for business has increased, the essential point is that they have survived as an independent profession. Practices have tended to increase in size with some substantial mergers in the largest ones which have national and international networks. At least one British old-established substantial practice has gone under and some younger adjusters have left the profession to take up work as lawyers and insurance employees, for example. Practices have invested heavily in support staff and office equipment, and some have set up their own substantial databases for various purposes, including fraud control, a matter of increasing concern to insurers. Given the diverse background of adjusters, who are usually qualified as insurers, quantity surveyors, engineers, lawyers or police, for example, before they take the institute's professional examinations, it is striking that they have remained as committed as they have. True, the state has taken little interest in adjusting because it is a specialised profession servicing mainly large businesses, but the conclusion must be that adjusters, having succeeded under the traditional model of the profession, have so far survived the pressures of the latter twentieth century.

Estate agents, who were referred to above, provide a neat contrast (Clarke *et al*. 1994). They made persistent efforts to organise effective professional bodies from the end of the nineteenth to the mid-twentieth century, but were outflanked on the one hand by the success of related occupations, notably surveyors, who succeeded in professionalising and whose members continued to undertake estate agency, and on the other hand by the continuing influx of novice estate agents who, since no registration was required, could set up in practice very easily and emphasised the business side of the work. The experience of estate agents between 1960 and 1990 is instructive. The 1960s saw determined attempts by the various professional bodies to resolve their differences in the common aim of finally achieving registration and state recognition. This led to the establishment of an umbrella body for that purpose, the Estate Agents Registration Council and this in turn to negotiation over the first substantial piece of legislation regulating estate agency, the Estate Agents Act 1979. This was one of the final acts of the outgoing Labour administration. It reflected all the anxieties as to the cartel-like features of professions that had by then become prominent. Estate agents had been banned from charging scale fees and were known by the OFT to be capable of establishing local fee cartels. The OFT was hence sceptical as to the merits of registration which was not achieved in the Act: no professional body was recognised as responsible for estate agency. Even worse, no licensing system was proposed, and despite long-established public anxieties about the dubious practices of some estate agents, the government's conclusion was that the public were better served by market competition. Whether the public was generally capable of making discriminations in what is not a frequent transaction for most, and what is also by far the largest financial commitment for most, was not investigated. Instead the Act imposed a system of negative licensing: anyone can become an estate agent unless they have a record of dishonesty. The OFT as the licensing authority acquired powers to ban or warn estate agents, and to declare certain kinds of conduct undesirable practices and hence the basis for sanctions. A number of other requirements were also laid down, such as having separate client accounts, written notice of fees, and being explicit as to interests the estate agent might have in a property for which he was acting as an agent. The solution seemed to be to attempt to target unacceptable practices, introduce minimal safeguards and leave the rest to the market.

This, however, was not all that estate agents were to suffer. With the property boom of the 1980s the large financial institutions – banks, insurers, building societies – began to see benefit in being in the housing market, since then they could direct purchasers to their mortgages and endowment and buildings insurances, and hence perhaps to other financial services. In a mad rush, vast numbers of estate agencies were bought up and were formed into national networks under the corporate owners' new brand name and livery. The object was to use the good name of the financial institutions to impress the public with the ability to deliver an improved, uniform estate agency service linked conveniently to the necessary financial services and so clean up and tidy up estate agency. The actual outcome was disastrous in every respect. The corporates discovered that it was much harder than they had assumed to bureaucratise and proceduralise estate agency and that there was an element of personal service, client care and professional skill and judgement in doing this successfully. They also created further conflicts of interest by attempting to sell their financial products alongside their properties and significant sections of the public were decidedly sceptical, particularly when the boom accelerated and the corporates began to make sales conditional on take-up of mortgages and endowment insurance, a practice that was subsequently banned by the OFT. Finally, the corporates discovered in the ensuing housing slump that estate agency is not easy, and many were forced to bale out, taking huge losses. While estate agency by its nature is at the margins of those occupations capable of professionalising, there is no doubt that there is a case for doing it, just as there is a case for the public interest being served by competition. The fate of estate agency provides an indicator of how much the balance between the two has swung in favour of the market in recent decades and of the establishment of antagonism to professional self-regulation.

Where the need exists, however, new professions can still emerge, and indeed be insisted upon by the state as the guardian of the public interest. The case of insolvency provides a clear example of this, and that of financial advice an indication of how crucial the state has now become in professional regulation. Company failure, like audit, and probably to a greater extent in the nineteenth century, had long provided work for accountants, and to a lesser extent for lawyers. The latter regarded insolvency as rather unsavoury, involving as it did the vigorous defence of remaining assets and collection of debts, and in any case lawyers' skills tend to be linguistic rather than numerical. In the twentieth century, concern grew about various aspects of insolvency in the postwar period. There were anxieties that companies might be liquidated when there was a chance they could be restructured and rescued as going concerns, and in particular that bankruptcy proceedings initiated by a single creditor might bring down a company. There was no equivalent to the American Chapter 11 provision, which allows companies temporarily to hold off creditors at a time of crisis, pending a potential resolution of the problems. Further, abuse of insolvency had become a source of regular complaint, with unscrupulous entrepreneurs trading recklessly, running up debts, going into liquidation and then beginning again phoenix-like, with a new company sometimes even buying up the assets of the old one in doing so. In this process the habits of some liquidators were called into question, and it was evident that there was a fringe who were willing to collude with rogue entrepreneurs. These problems were regularly featured in consumer programmes, as small investors, trade creditors and customers suffered (Wilson 1983; Aris 1985).

One target of the Insolvency Act 1986 was hence the regulation of insolvency practice. For the first time a formal licensing system was established with a special recognised professional body, the Insolvency Practitioners Association, to accredit practitioners, in addition to other recognised professional bodies in accounting and law. By 1994 when the new regime was established, the IPA accounted for 13 per cent of practitioners, the Law Society for 11 per cent, and accounting bodies for almost all the rest of the roughly 2000 registered practitioners (Flood and Skordaki 1995, p. 13). The professional bodies collaborate to administer a single professional qualification, which is the essential qualification in addition to any others (legal or accounting) they may have. Although insolvency work involves accounting skills, it is substantially different from most other accounting work. It involves an intense period of activity in the early stages of appointment in order to understand the circumstances fully in order to trace and secure assets, and where possible to sell a company as a going concern before confidence evaporates, as in service companies it may do extremely rapidly. For example, an advertising company was sold within six hours and a global money brokerage within three days. Other appointments, especially those involving liquidation, may take much longer and be extremely demanding: staff have to be told that they have no jobs, creditors that their chances of recovery are limited. One practitioner commented

> You work for 16 or 18 hours a day from your base at the premises of the company. In the *x* case, for two/three days I ended up not going

> to bed, catching up with a bit of sleep on a sofa when possible. How do I cope? Meat and drink. Others get tired, they are wimps. With the *y* case we had to stop a plane at Gatwick before taking off. The plane was full of school kids on a skiing trip. It was hard to explain that they weren't going to go any more. Also in times of recession there were lots of nursing homes going into receivership. Before the 1986 legislation, there were too many cowboys and a lot of malpractice in insolvency. Licensing began to weed them out.
>
> (Flood and Skordaki, pp. 24–5)

Insolvency then, saw the marriage of the professional model, taking advantage of established professional bodies in law and accountancy, with state-initiated action to improve and regulate practice. Licensing is still devolved to a new professional body, but subject to state supervision – a minority of practitioners are licensed directly by the Secretary of State. The outcome is the creation of a new profession as a result of recognising both the need for tighter regulation and the distinctiveness of its demands from those of the professions whence it came.

The final example, financial advice, illustrates both the limitations and the opportunities of the state-regulated profession (Clarke 1998a and forthcoming). Pressure for the protection of the public from unscrupulous advisers came from abuses in the 1980s, especially the mis-selling of personal pensions to people who would have been better off in occupational schemes. The numbers affected and the costs of compensating and re-instituting victims are constantly revised upwards as the industry is gradually forced to accept responsibility, but certainly involve millions of cases and billions of pounds. In this case the pressure for professionalisation comes from the failure of state regulation. The Financial Services Act 1986 imposed a series of requirements upon the retail financial advice sector which had been subject to only very limited and patchy state oversight before. The fundamental difficulty was that distribution of financial investment products, including personal pensions, was dominated by the large sales forces of the major product providers, notably insurers. These were joined by the banks and other financial institutions, which rapidly began to attempt to exploit existing contacts with customers as account holders in order to sell them other investment products. All these participants in the market were naturally concerned to sell their own products, though some were prepared to contemplate offering those of a limited range of other providers. Independent advice was on offer from a rather motley variety of advisers and brokers, many of them former life-assurance salesmen. The best of these had high standards of competence but, in the absence of regulation, the worst were decidedly limited. Most derived their income from commission on sales rather than charging fees and hence there was a danger that products offering the best commission would be favoured, a point not lost on product providers in promoting new products through the independent advice (IFA) route.

The regulatory solution to these dilemmas was to insist on the registration of all sellers and advisers and their regulation through self-regulatory organisations recognised under the Act, one for the product-providers and one for independents. Sales were then only permitted either by representatives of a sole company (tied) or wholly independently with no intermediate arrangements. This principle of polarisation was intended to put the customer on notice as to whether he was receiving impartial advice or not, but the onus was left on the customer to shop around and bear the consequences of his or her final judgement. This, however, failed to take account of several difficulties. First, the distinction between sales and advice was hard to pin down in practice. In principle both tied and independent sellers could advise impartially and according to specifiable standards on what the customers' needs were, and regulation was gradually developed to require that they do so. In addition, competence was insisted on by the imposition of a common examination, mandatory for the tied and independent sector from 1997. Once a diagnosis of the customers' needs has been made, however, the tied seller can of course only offer products from his or her company, which might, first, not include any of the appropriate type; and secondly might well not include the best available, even if the type was suitable. Was it reasonable to expect sales staff, paid substantially and at times wholly on commission, to restrain themselves in these circumstances?

The extent of mis-selling of pensions plainly indicated that it was not. Further, the more the regulation extended the contact between seller and customer before a sale was permitted, in order to ensure that a full account was taken of their circumstances, the more substantial the advising relationship with the customer. Since customers are very widely ignorant about financial services products, and since pensions in particular are complex and involve payments for long periods before obtaining a return, and that return when it comes is critical to the customers' financial security, it is plain that restraint is essential in selling. Further, sales staff habitually used the need for advice as a basis for cultivating a quasi-professional relationship with customers, in which they were encouraged to be passive clients rather than active, questioning consumers. Other matters apart, the time taken in fulfilling regulatory requirements with each customer is a deterrent to the salesman 'losing' a sale, and to the customer repeating the process several times in shopping around with other companies.

The need for professional advice was hence inherent in the relationship between buyer and seller, yet the government insisted on a market relationship, and reforms eliminating tied selling were not instituted by either government (Conservative or Labour), even after the extent of mis-selling and the reasons for it became apparent in the mid-1990s. To do so would have been to insist that sales go through the independent route and this was not feasible, both because there were not enough independent advisers to service the country, and because their levels of competence were so varied. In addition, such limited research as there was suggested that customers were on the whole content to pay commission on sales rather than paying fees at a professional level instead, although they were quite aware of the dangers of commission bias.

The outcome, as regulation progressively tightened, was that tied sales by traditional sales forces became a more and more expensive system of product distribution, especially in comparison to sales through the IFA sector. Direct sales forces hence fell in numbers, where IFAs remained steady and their market shares grew. Efforts were made from the early 1990s to form professional bodies with leaders explicitly pointing to the advantages of professionalisation as a way of restoring public confidence. Two obstacles stood in the way of progress, however. First, there was rooted suspicion by IFAs of the capacity of the tied sector to be able to behave professionally in practice, despite the formal possibility of drawing a distinction between advice and selling. Secondly, the state had by now taken over responsibility through the regulator (by 1998 in its third form) for accreditation, training and the maintenance of sales standards and discipline. This led to practitioners forming themselves into professional bodies with little possible function except that of sectoral representation, the job of the trade association, unless the regulator was prepared to cede authority to them.

With financial advice then we have the emergence of the space for a new profession but the intervention of the state to occupy that space as regulator and hence pre-empt professionalisation, at least in its traditional form. At the same time the need for professional advice was constantly submerged by ideological commitment to market values and an insistence on *caveat emptor*. It was not a situation that satisfied anyone, but the final outcome was not obvious, save that the state was unlikely to quit the field in favour of an emerging professional body.

Accountancy: a regulatory profession

Accounting is a profession whose success is distinctively modern. In Britain, the US and other countries it has owed its development to the demand for a reliable account of the financial situation of companies which are sustained by the subscription of outside investors, the shareholders. Where, as in Germany for example, investment comes largely from banks who are long-term equity participants and therefore have a quite intimate knowledge of the company, this need is less pressing, but it has been in any case supplemented, as companies have grown larger, more complex and dynamic, by the need for accounting for internal purposes in order to keep track of the flow of funds and so to be able to evaluate the cost of particular activities – the development of a new product, its profitability when launched, the continuing cash flow from a newly acquired subsidiary, for example, not to mention keeping track of the costs of replacing increasingly expensive capital equipment and the fluctuating value of real property and foreign currency debt. This internal function, cost and management accounting has hence grown up in the twentieth century to complement the external auditing that was required from the nineteenth.

It should be said, however, that the requirements of audit were not very onerous even in Britain and America until the twentieth century. Thus, it was not until 1900 that every British company was required to have its balance-sheet and accounting books audited, and not until 1948 that auditors were required to be qualified accountants and to report on the truth and fairness of the accounts, that is, legally required to express a professional judgement (Roslender 1992, pp. 180–1). Bricker *et al.* (1993) point out that in the US audits were not investigative until the 1930s, and that up until the 1900s they reflected in their emphasis on the balance sheet the bank's predominant role as a source of capital. In both Britain and America, accountants began to form themselves into professional associations in order to claim access to the increasing amount of work, though in rather different ways in each country, which highlights the dilemmas of accounting. Like other professions, accounting has developed an expertise and has successfully sought control over it, and in particular over the accreditation of members. This was a rather limited and unsuccessful process in the US in the nineteenth century, with the predecessor of the American Institute of

Certified Public Accountants being founded only in 1887 and having less than 100 members by 1900 (Bricker *et al.*, p. 104). In contrast, the English Institute of Accountants, founded in London in 1870 on a classic basis of reaction to a series of scandals which had brought accounting into disrepute, and with the explicit intention of bring together reliable, competent, gentlemanly accountants (at 50 guineas membership), all to be subject to examination following a brief initial period, and with restrictions to two articled clerks per member at any one time, clearly intended to press its elite status. It received its Royal Charter 12 years later, the most prestigious and difficult route to exemption from the provisions of the Company Acts, the other being application to the Board of Trade. The Institute's rapid success provoked those practising as accountants who could not or did not want to become members to form rival associations in a process of competitive professionalisation which remained unresolved until after the Second World War. One effect of this was to frustrate the objective of registration, that is, of one body obtaining the right, sanctioned by Parliament, to call themselves accountants and practice as such, since every time one body sponsored a registration bill, others lobbied against their exclusion. Even though the English Institute came to dominate the profession in numbers and prestige by the end of the nineteenth century therefore, the situation remained more fluid than in the US, where by 1921 all states had passed legislation licensing certified public accountants. In Britain it was the Companies Act 1948 which finally designated members of the main accounting bodies as accredited to perform audits. In the US the lack of early professional organisation left the initiative to the state, an initiative which was driven decisively further by the Wall Street Crash of 1929, the ensuing evidence of financial scandals and abuses, the Great Depression and the introduction of the New Deal as the response to it with, notably, the creation at federal level of the Securities and Exchange Commission as regulator. In the 1933 and 1934 Securities Acts the federal government acquired the power to subject publicly traded companies to financial audit, for the auditors to be subject to civil liability, and for the SEC to set accounting principles by which audit was to be conducted (Bricker *et al.*, p. 106).

The interesting feature of both (and, one could add, other) countries is that the state and the legislature were evidently reluctant to step in and take over audit training and certifying auditors. To do so would have been to have to come to grips with accounting as a professional expertise, and there were several powerful reasons why they fought shy of doing so, as we shall see. As Bricker *et al.* (1993) show, the threat of state action was sufficient to achieve very rapid progress. By 1939 the American profession had substantially united into one body, and committees on accounting principles and on auditing procedures had been formed. The outcome was a fairly powerfully maintained system of devolved responsibility to the American accounting profession. Despite some nasty episodes in the 1970s and 1980s, when the SEC's relationship with the AICPA was subject to hostile scrutiny by Congress amid allegations that it had become too cosy, the accountants managed to stay on-side by constantly moving to improve accounting standards, for example by establishing the Financial Accounting Standards Board in 1974, which develops and promulgates standards binding on the profession. The statutory involvement of a powerful federal agency, the SEC, together with the intrusion of a sceptical Congress, with its well-resourced committees, from time to time, drove American accountancy forward and forced it to confront unpalatable conflicts of interest as well as the constantly emerging complexities of accounting.

In Britain, by contrast, the profession, and the Institute in particular, had a more powerful grip on developments and met less resistance. The Institute merged with the largest of its rivals in 1957 and then settled into a pattern whereby it was divided geographically through the Scots and Irish Institutes, and functionally with the Chartered Institute of Management Accountants and the Chartered Institute of Public Finance and Accountancy, with only the Association of Certified Accountants in direct competition. In the second phase of British development identified by Willmott (1986) up to 1970, accounting experienced powerful internal differentiation expressed in the rise of internal management accounting and public sector accounting, notably for the state-sector industries nationalised after 1945, and for central and local government. There also emerged an important differentiation by size of the private practices as some grew larger and larger, eventually becoming multi-national firms with thousands of partners and fee incomes of hundreds of millions of pounds, mirroring the growth of the multi-national corporations which they competed to audit. This stratification and diversification created tensions as to the unity of the profession which the professional bodies sought to resolve by further mergers, only to be rejected by the members. For as differentiation by function and type of work among accountants grew, those working in different areas began increasingly to see themselves as in different professions – it is, after all, the nature of the work and the detailed character of the expertise and the judgements that it calls for that give practical unity and a sense of collegiality to a profession. Unification was further made problematic by the practical domination of the English Institute, which would essentially have made any merger a takeover, with consequent loss of identity for the junior partner.

The pressures on accounting were the same as those in America, however, for by 1970 pressures were starting to grow on the issue of accounting standards and independence, especially in audit. Weaknesses in accounting and audit were shown to be evident in a series of well-publicised corporate failures in the latter 1960s and 1970s, which raised questions of competence and of the application of uniform standards and auditor independence (Clarke 1981; Sikka and Willmott 1995). The reaction was the formation in 1974 of the Consultative Committee of Accounting Bodies as an umbrella organisation to coordinate more acceptable and unified practice, which gave rise to the Accounting Standards Committee, which began to produce detailed standards in the manner of the FASB in America. The role of Congress was taken, in a rather low key, by the Secretary of State for Trade, who warned that failure to act decisively would lead to the creation of an SEC-type body (Willmott 1986, p. 572).

This process of state insistence on professional action, although it has produced some beneficial results, has not solved the problems of accountancy, which can be seen as layered. So far we have only referred to the upper or more manifest layers. One of the difficulties that we have seen is of the work of the profession segmenting, making unification more difficult. This differentiation, however, is not like that which has occurred in medicine or law, for example, though there are parallels in some areas of work coming to demand far more prestige and money (surgery, commercial law) than others (geriatrics, family law). The important difference with accounting is that it does not constitute its own substantial territory like law and medicine, but seeks to colonise and provide services to established institutions, particularly businesses, which are at the core of power and wealth in society. This has raised questions of independence in particularly potent forms. We accept the ministrations of doctors as a means to the universally approved objective of health for all members of society; we are a little more equivocal as to the ministrations of lawyers as a means to upholding our rights, because they are so expensive that substantial inequalities of access are involved. The key public function that accountancy provides is audit, yet this is only one of the increasing variety of services it offers, and in addition auditors are appointed and paid for by the boards of companies. In the years up to the 1970s, accountants were generally successful in using explicit or implicit claims to professional integrity and independence to defuse concerns about the uses to which audit was put. It was supposed to safeguard the quality of the annual report to shareholders, but control of audit is exercised by the board, and effectively by senior management. Is not their view hence likely to prevail, and is there not a danger that auditors may be more compliant than they should be in the hope of reappointment?

From the 1970s onwards, several factors began to potentiate this issue. An important initial response was to emphasise the purely technical character of audit and the dedicated expertise of accountants: meticulous men in suits checking endless documents and reconciling figures to see that mistakes and worse had not been made, but men of professional training and integrity, who in any case move from audit to audit and are not dependent on auditing any one firm. Well, yes, but being boring is not a solution, particularly as accountants are also tediously insistent on their own financial interests and are normally required to fill in detailed daily and weekly timesheets, in which a minimum number of hours must be billable, a practice that would be seen as distasteful by lawyers and doctors, even though they have moved in that direction. Accountants are money men and they ensure that they are paid, and usually quite well. They work in, and mix with, businesses even if they are not businessmen. Business and finance is their stock in trade, not something to disdain. Indeed it was the gentlemanly disdain of lawyers that gave English accountants their opportunities in the nineteenth century (Sugarman 1995).

It would seem crucial, then, that accountants, as auditors first, be able to demonstrate their independence from boards of directors, secondly be able to demonstrate the technical independence of their expertise so that any failings would clearly be technical and professional failings and sanctionable as such, and finally not be compromised by any additional conflicts of interest. Accountants failed each of these tests, but they had a powerful secret weapon which they deployed with increasing effectiveness. The independence of boards was repeatedly shown to be a sham in company failures in the 1970s and 1980s where, one way or another, auditors became subject to undue influence on both sides of the Atlantic. Indeed, almost any major corporate failure was likely to reveal audit failings as a result of the capacity of companies to influence auditors. This is not a simple process in all cases, although the use of inadequately qualified staff, too relaxed a view of the client, and the hope of reappointment have all contributed at times. Requirements in the regulation of audit have been introduced to mitigate this. Short of state takeover of audit and the payment of salaries to auditors, with careful rotation between companies like tax inspectors, these risks cannot be eliminated. They were made a lot worse by the reasons for failing the other tests.

As accountancy has developed, it has diversified into other activities, notably tax advice, information technology consultancy and general management consultancy. In addition, the stratification of the profession has led to the emergence of a very few large and powerful partnerships, first known as the Big Eight, then reduced to six and then in 1998 to five multi-national firms. These are highly diversified, earning only a limited part of their income from audit, which can be used as an access route to sell other, more lucrative services. The argument has been that competition for audit of the large companies, which only the large accounting firms can undertake, has led to 'low balling' or offering audit at below cost in order to gain access. The implications of these conflicts of interest are evident, as are the problems of the inevitable closeness of the relationship between the large accounting firms, big corporations, the relevant areas of the state, and the upper echelons and decision-making committees of the profession: accountancy at this level is inevitably corporatist. Thus Mitchell *et al.* (1994) were able to show that, despite the regular criticism of auditors by Department of Trade Inspectors in the wake of corporate failures, no one had ever been disciplined by their professional body. Further, firms with members who had been criticised almost inevitably later contributed members as inspectors in DTI reports, since inspectors are usually one lawyer and one accountant drawn from leading members of the profession. Similarly the decision-making, lobbying and disciplinary machinery of the accountancy profession is bound to have members of the dominant firms on them, so that the entire system operates in a self-justifying fashion. The reason that this is tolerated by the state is that, short of effective public outcry against it, it is much better to leave the problem to the profession to deal with than to take responsibility for it itself – but here we encroach upon the concerns of the next chapter.

Further problems are created by the reasons for the failure of the second test. If accountancy has developed a systematic expertise, it should be possible to insist on audit to professional standards, and hence on the necessity for sanction on all audits falling short of that. One reason for the reluctance of the profession to sanction its errant or complacent members is that accountancy certainly involves expertise and a great deal of technical knowledge but, first, it has developed no theory. and secondly it reflects business, which is highly dynamic. Accountants, or the more senior and reflective of them who comment on such matters, hence refer to accounting as an art rather than a science, the application of a series of techniques or conventions. Like lawyers, good accountants are inventive with the use of their technical expertise. Since there is no fundamental accounting theory, the development of conventions has become of exceptional importance. It was not until the 1980s that it became forcibly apparent just how significant this could be, as it emerged that there were a large variety of ways of legitimately drawing up balance sheets and profit-and-loss accounts. Even worse, new problems began to arise constantly in the 1970s and 1980s as a result of the dynamics of business. Thus the inflation of the 1970s made a nonsense of much conventional accounting: the value of stock and its replacement costs rose and the cost of replacing capital equipment increased very rapidly, the value of real property rose even more dramatically, and also could fall in certain market conditions. How were brands to be accounted for, especially when they were acquired? How were acquisitions more generally to be incorporated into the consolidated accounts, and in what ways were they to be construed as assets and as liabilities? With the takeover boom of the 1980s these and other matters raised corporate reporting to an art form that was used to declare highly doubtful profits and to sustain inflated share prices. Nor was this ingenuity confined to fringe or fly-by-night operators, though a good many of the leading practitioners eventually crashed (Smith 1992; Sikka and Willmott 1994).

By the 1990s, therefore, accountancy had reached an extraordinary position. It had been involved in obvious abuses and scandals, yet its members were largely undisciplined (though the numbers of civil suits brought by creditors, often in insolvency administrations administered by the same large firms of accountants, had increased greatly). It was subject to obvious and persistent conflicts of interest in auditing. It had not developed and had shown no real interest in developing any systematic theory, though it had shown an increasing penchant for the creation of binding accounting standards by way of agreeing new conventions to remedy the most egregious opportunities for abuses. Yet accounting continued to grow in boom and in recession, both in numbers and in the pay of its practitioners, both in private practice and specialist staff in the public and private sectors. How could this be? The answer once again is ideology. An account, in the ordinary meaning of the term, is a story with connotations also of being an explanation. Accountancy is not concerned with any stories other than financial ones, however. It owes its success to the rise to dominance of finance – money – in the economy and polity of industrialised societies. As businesses became larger and more complex, keeping track of where money is and where it flows became more and more pressing, because of the dangers that the business can be destroyed by unrecognised indebtedness or lack of finance. External financial support from shareholders, banks and the state has only served to reinforce this need for constant financial information for both internal and external consumption. But business is not conducted solely on the basis of financial rationality – what costs less and what earns more. Businesses in the nineteenth century, before the rise of modern accounting and before the establishment of internal audit and management accounting, operated successfully without such information, much as small businesses do today. Judgements were and are successfully made about where opportunities for developing trade lie and where they are waning, about the successful cultivation of trading partners and about the development of products and services and the achievement of quality, without constant detailed reference to costs and revenue.

The advantages of accounting for the modernising enterprise were, however, substantial. In the first place it promised to restore control to senior management and the boards of businesses, which were becoming more complex, dynamic and unwieldy. Accounting, notably management accounting, permitted management to see where money was being earned and where it was not, to see what processes were costly and what were cheap. It hence received a boost during the First World War at the behest of governments, who were letting large contracts for the war effort and wished to avoid being exploited: cost accounting enabled businesses to know that profits were reasonable (Loft 1986). It also formed a vital part in the counter-attack of business to the onslaught of labour around the turn of the century, which saw mass unionisation, the rise of socialist parties, widespread strikes, the Progressive era in the US, the Russian Revolution and the British national strike. Businesses needed an answer to labour's demands for better working conditions, shorter hours and better pay – or no pay cuts. It was increasingly being portrayed as overmighty and greedy, and the prospect of total expropriation was actively being canvassed. Accounting techniques, together with the new 'scientific management' of Frederick Taylor offered secure intellectual ground for employers to show what could and could not be afforded, and the apparently secure prospect of organising work to maximise efficiency and hence ensure the success of the business.

Thus the refusal to yield became transformed into an account of why it was impossible to yield, and unions could be drawn into detailed negotiation rather than hostile confrontation. Accounting and scientific management itself, reinforced by the growing managerial revolution, the separation of the ownership and management of companies, with managers presenting themselves as technicians charged with securing the success of the business as a whole, hence achieved a crucial shift in neutralising and technicising debate and transforming it from one in which increasingly all issues could be drawn in, including the fundamental objects of the business and the rights of property, to a technical discussion of what could be afforded and how best to organise work (Miller and O'Leary 1987). This did not eradicate labour's sense that this was at least partly a trick, and the interwar depression did little to enhance faith in the capacities of capitalism for self-control and managed growth. The postwar boom, which took full employment and managed growth as a leading objective did, however, and accordingly this was a period in which accounting was able to cultivate its useful grey image with some success.

The trick, of course, was who was providing the basis of accounting, the new story. Accountants sell stories and they invariably have morals which reflect the interests and objectives of those who construct them. Thus, as the postwar boom petered out by the early 1970s, accounting began to appear more explicitly as a means of manipulation rather than a technical neutral instrument. This was evident in the failures of corporate reporting and the 'window-dressing' of accounts (Clarke 1981; Sikka and Willmott 1994). It was also evident in the increasingly turbulent political environment in the private and increasingly in the public sector, which had by that time become large. Hence it was not merely business but government which argued that 'we cannot afford it'. Political debate, including election campaigning, shifted from its historic concern with broad objectives and new or altered institutions (socialised medicine, public housing, developments in education, for example) to increasingly technical and bitter debate about fractions of a percentage point in pay rises, subsidies to rescue ailing companies, calculations of unemployment rates and desperate attempts by government to do businesses' work by imposing wage and price controls in order to manage the entire economy as a business. This was not, of course, accounting, but it was accounting rhetoric. What it lacked was the political capacity to enforce it.

This the new right governments of the 1980s mobilised very effectively. The power of organised labour was crushed by high unemployment and hostile labour laws, and the public sector was progressively privatised, so incidentally providing vast amounts of work for the larger accountancy firms in developing prospectuses and then conducting audits of the privatised firms. Business principles were introduced into the state itself, with the creation of more or less autonomous units hived off into internally accountable and self-financing quasi-private entities. Similar initiatives were introduced into hospitals and general medical practices, and into schools, who were encouraged to manage their own budgets. Governments cut their expenditure and operated by cash limits: instead of responding to what each sector needed, as in the past, they calculated what could be afforded, divided it between the different sectors, and shifted responsibility outwards to achieve 'efficiency savings'. It made no difference for critics to say that new right governments knew the cost of everything and the value of nothing. For the time being the dire issue of inflationary costs had been confronted and, even better, some savings had been passed on as tax cuts.

The boom, especially in the service and property sectors, that these stimulated further demonstrated the usefulness of accounting in the hands of increasingly sophisticated managers and entrepreneurs (Smith 1992; Sikka and Willmott 1994). As we have seen above, there are parallel difficulties which conspired over time to put pressure on accountants to establish more genuinely enforceable and acceptable standards in respect of company reporting and audit. In the present context, however, this only reinforces the importance of accounting as a way of understanding, explaining and legitimising what to do. Accounting has been extraordinarily successful in deflecting criticism, given its decidedly practical position (Willmott, in Streeck and Schmitter 1985; Willmott 1986; Mitchell *et al.* 1993a, 1993b). The 1990s saw the re-emergence after almost 30 years of the notion that there are other legitimate stakeholders in business enterprises – employees, governments, customers besides shareholders and managers. The 1960s saw a burst of effort, especially by academic accountants, to engage with this in attempts to construct 'social accounting' and 'environmental accounting' to take account of these interests but as Roslender remarks (1992, pp. 98–105), it failed to take root in the Anglo-Saxon world, though it has found formal expression elsewhere, for example in the Bilan Sociale required of larger French companies. Overall the success of accounting has lain fundamentally in establishing finance as the primary way of understanding economic life and additionally in achieving considerable success in identifying accountancy with the interests of management in (especially big) business, rather than shareholders, still less other stakeholders.

This raises the question of the relationship of accounting to the state. We have seen that in both Britain and America the state has been content to allow accounting to do its work and particularly to discharge the function of audit with the minimum of intervention. Even when it has plainly been shown to be inadequate to the demands of the day, the state has not moved decisively to take over responsibility but it has increasingly insisted on improved standards and greater clarity. This has not so far involved much in the way of public accountability and discipline, in the way in which law and medicine is moving, though things may be changing even in Britain. The Labour administration of 1997 expressed its commitment to the independent regulation of accountancy, and the accounting profession put forward proposals to accommodate it. Further, the proposals were designed so that other professions could be brought into the same system. (R. Bruce, *The Times*, 11 June 1998). The government dallied, however. Given the tenor of this chapter, to the effect that government oversight and public accountability of the professions in general is the norm at the end of this century, and that hence they have to rely on the extent and significance of their expertise and can no longer take comprehensive autonomy for granted and the problems of accounting outlined above, this delay is interesting. While naturally the contingencies of political power are a likely explanation in part, it also connects with a wider view articulated by Johnson (1992).

He points out that in a liberal democratic state the professions serve a useful purpose in establishing discourses in terms of which to account for and manage a variety of areas of life, thereby removing them from the directly contentious realm of daily political life. We have seen this above in respect of accounting and a similar argument has been mounted in respect of medicine. As Johnson puts it

> the state is not here conceived as some external conditioning involvement of government. Rather the state is the outcome of governing: its institutionalised residue so to speak. It also follows that those procedures and technologies, forms of classification and notation, that in part embody the state are embedded both in those formal bureaucratic organs that we normally identify as the state apparatus and the agents of institutionalised expertise, the professions. In short, the state, as the particular form the government has taken in the modern world, includes expertise or the professions. The duality state/profession is eliminated. (p. 7)
>
> One result of such reconceptualisation will be the recognition that the 'neutrality' of professional expertise, where it exists, is in itself

> an outcome of a political process, rather than the product of some inherent essence, such as esoteric knowledge. (p. 14)
>
> Because governments depend on the neutrality of expertise in rendering social reality governable the established professions have been as far as possible distanced from spheres of political contention and the source of professional autonomy. However, because government policies and policy objectives change over time, these boundaries are in constant flux, having the effect of refashioning jurisdictions, breaking down arenas and neutrality, and reconstructing new ensembles of procedures, techniques, calculations and roles, which reconstitute the lineaments of the state itself. (p. 18)

This process has become reasonably explicit in the case of corporate governance, with reform being delegated to *ad hoc* committees headed by leading businessmen (Cadbury, Greenbury) but dominated by senior accountants. As Freedman (1993, p. 295) puts it:

> The profession and bodies sponsored by it have taken on a public role in the absence of action by the legislature. Indeed, government has encouraged this development. Accountants have not been reluctant to take on this task, which offers them a certain amount of control of their destiny, participating in issues such as rotation of auditors and the relationship between audit and non-audit work. The setting up of and sponsorship of independent bodies which endorse their 'solutions' gives them greater legitimacy.

Change in the professions, and relations between them and the state are hence likely to continue, and in the course of it their status as officially sanctioned agencies of the state with fuller public accountability is likely to become greater.

4
State Regulation: Achieving Ascendancy

As we have seen in the previous chapters, private regulation is very widespread and diverse. It usually precedes state regulation, and inevitably accompanies it in the sense that there is a necessary element of collaboration, even in cases of well-resourced and powerful state agencies, though the extent of private and particularly regulatee involvement in the regulatory regime is a contingent matter to which we will return. There are a number of significant considerations for the state in initiating or increasing regulation in any area which are bound to make it cautious. One of the most evident to governments contemplating such a move, leading to the creation of more regulatory machinery, is that, if the state intervenes, it bears responsibility for the effectiveness of the outcome. There is hence considerable mileage in allowing private or self-regulation to survive. On the other hand, if existing arrangements have plainly been shown to be hopeless, very often through a series of scandals and abuses which have received wide publicity, usually through the press, governments may suffer more by failing to act. If a new category of business emerges, which either has known hazards, such as nuclear energy, or poses parallel problems to those already regulated, such as satellite and cable television, the need to regulate may be readily accepted.

Governments are well aware that by being willing to regulate they can gain general public support, because they are seen to be acting in the public interest to prevent abuses. Sometimes such action may be seen as politically necessary in order to legitimise a government initiative. Thus the privatisation programme of the Thatcher government was seen to require the establishment of a series of regulators for the utilities, because these were actual or near monopolies. More widely there was a paradoxical quality to much of the campaign by new right governments to 'restore' the functioning of 'free' markets. Despite the emphasis of such governments on deregulation and efforts, discussed earlier, to 'reduce the regulatory burden on business', the 1980s and 1990s have seen a great deal of new regulation. We shall return to this conundrum below in a review of some examples.

The downside for governments initiating regulation is a good deal more complex and uncertain than the kudos of being seen to be acting. Public expectations will certainly be increased, which means that sensitivity to abuse will become much greater. A classic example of this is insider trading on the stock market which was a taken-for-granted practice until the 1960s. If you worked in securities you did so in order to have opportunities to make money, and the access to privileged information that you acquired was naturally something to be taken advantage of when the opportunity arose. It was only with the rise of expectations of wider public access to stock markets on the basis of equality of access to information that such conduct became outlawed. Similarly, nuclear-radiation leaks which in the past would never have reached the public domain are today regularly admitted, for fear that the information will come out later and cause a scandal.

Such increased expectations may also lead to moral hazard, that is to the public coming to rely on state regulation to achieve their complete security and so fail to take prudent measures themselves. This has clearly been a problem in the BSE affair. It had also been a significant risk in the efforts of new right governments to increase public participation in the financial sector, and particularly in stock markets, with new investors relying on state regulation to protect them against market volatility.

A further problem for the state is cost. In order to have a chance of being effective, regulation needs to be adequately funded. One of the most fundamental requirements of regulation is for regulators to have adequate time to familiarise themselves with the evidence in their sector. If they do not have enough staff with the necessary ability and training they will be constantly running to catch up with events. In many cases there will be effective competition with the industry or sector in question for quality personnel, so exercising pressure on salaries. Who is to bear the direct costs of regulation? The industry will have to bear the indirect costs of providing information, liaising with the new regulators and complying with their requirements, and they will be sure to make known just how demanding and expensive this is. Is a new regulatory agency to be funded from taxation? That will give it complete independence, as opposed to imposing a levy on the industry, either as a form of sales tax, or on firms according to size. On the other hand, funding from the public purse is yet another burden on a resource that has been subject to enormous strain, and the constant competition for resources may well mean that an agency may have its budget cut during a recession, or because it cannot compete politically with the demands of health, education and welfare.

The state has also to decide what powers to give an agency, perhaps one of the most difficult decisions of all. It is easy for those involved in initiating the regulation to point out that, in order to get a firm grip on a problem that has caused serious public concern, substantial powers are necessary. Willingness to legislate such powers also clearly expresses a government's determination to tackle a problem. Of course there is a relationship between the seriousness and extent of the risk which is being regulated and the powers of an agency. At the most limited it may be confined to monitoring the situation and reporting; at the most extensive it may have powers to pre-vet and license all or almost all of a sector's output, as is the case for the pharmaceutical industry, for example. A number of difficulties arise, however. First there is the issue of proportionality. Regulation should be appropriate, not oppressive. It inevitably restricts liberty and creates costs and delays. It is not simply a question of whether these are justified by the hazards which it has sought to bring under control, but also whether they are seen as greater or lesser than those in other sectors. There are thus the parallel arguments in respect of any individual new regulatory agency: how tough do we need to be to be reasonably sure of dealing with the problem; and how can we justify taking powers that put this agency on a par with others with similar powers? It is often easy to argue that considerable powers are needed because the problem is serious – if it was not it would not have climbed the political agenda – but much harder to justify such powers on a comparative basis.

These arguments will not be lost on the regulated, who will be only too willing to contrast the new regime in terms of effectiveness, appropriateness, fairness and rationality with whatever preceded it. They will also develop a cooperative or non-cooperative stance to the new regulator over time, and quite likely by the time the agency starts to function. This raises questions not just of the extent of the agency's powers, but of how they are to be used and whether they are effective. It is not always the most stringent powers that are needed. Thus, for example, food-poisoning outbreaks involving life-threatening infections such as salmonella and E-coli 0157 have been shown in a number of cases to be the consequence of failure to comply with the basic hygiene principle of not using the same knife to cut raw and cooked meats. A draconian but probably effective measure would be to ban the sale of raw and cooked meats from the same premises. Short of this, imposing severe sanctions for failures in basic hygiene, while probably necessary, if only as an expression of public sanction at least where deaths have occurred, is evidently to lock the stable door after the horse has bolted. What is needed is regular inspections by Environmental Health Officers (EHOs) and constant insistence on the need for vigilance, since staff and proprietors will not want the death of customers on their consciences. This does not require substantial powers, but it does require adequate funding to provide enough inspectors. The objective of the regulatory system in this case, however, is plainly to achieve the active cooperation of retailers and to maintain an awareness of the risk.

It is not just a question of what powers an agency has therefore, but how they are deployed, and the response of the regulated, individually and collectively, to them. At an individual level (taking this to be the regulated entity, often a business rather than a person) there will almost inevitably be some who are unscrupulous and recalcitrant. Thus, to continue with meat hygiene, EHOs would no doubt testify to the existence of a minority who are unmoved at the prospect of causing the death of some of their customers. For these, stringent powers are plainly necessary since failure to sanction effectively the most egregious offenders will bring the agency as a whole into contempt. It is

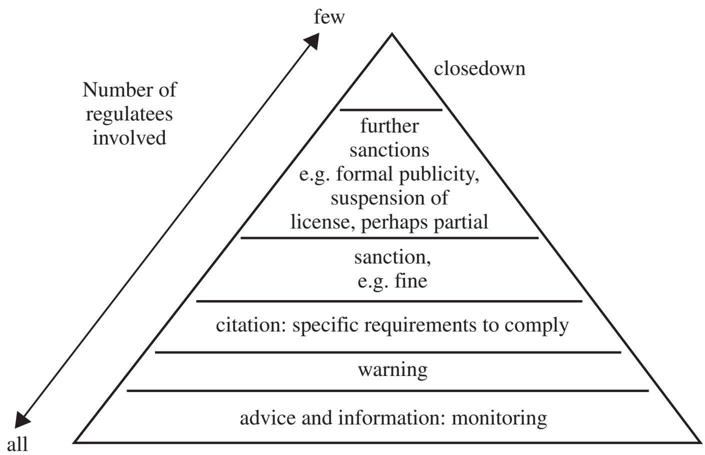

Figure 4.1 Regulatory enforcement pyramid (after Ayres and Braithwaite 1992)

partly for this reason that Braithwaite has argued that a hierarchy of sanctions is essential for a regulatory agency to have credibility. There are many ways of expressing, this but the essential points are first, that the regulated should be in no doubt of the existence and willingness to use powers of 'capital punishment' in extreme cases and secondly that the vast majority of regulation takes place at the bottom of the pyramid, where relations between the two parties are cooperative and not conflictual. Braithwaite has also argued for an inclusionary or reintegrative approach to regulation for all but the extreme cases and the use of shaming rather than other forms of punishment.

Regulation does not have to function in this way and may not do – an alternative mode is much more formal and codified, with specific verification that procedures have been complied with and standards met. The major difficulties with this approach are that the regulated will not cooperate. This is likely to have different manifestations at different levels. At the level of the regulated entity it is likely to involve ritualism, that is, formal compliance but actual avoidance. Anyone who has been subjected to a strict disciplinary regime such as the military will be familiar with the ingenuity that is stimulated in avoiding the spirit of rules while conforming to the letter, and the contempt with which authority may come to be held in consequence. Where regulation is overformal in other words, it becomes red tape, a pointless burden to be disposed of as quickly as possible. At a collective level the regulated will campaign, possibly in public, and certainly to their political masters, against the agency. This is likely to weaken the morale and political support of the agency and raise doubts in the minds of its staff as to the relevance of what they are doing. In any case there is almost invariably a large imbalance between the resources of the regulated and those of the agency. If the regulated wish to be obstructive they have many opportunities to delay, waste the agency's time and overwhelm them with irrelevant information and 'requests for advice'. Further, they will not give the agency advance notice of developments in products, services or organisations that bear upon the risks the agency is committed to regulating. The danger is, therefore, that the agency will be weakened and wrong-footed and generally be made both to appear and to be inadequate. If it responds by imposing heavy sanctions when it detects malpractice, the regulated will deploy both their lawyers and their public relations staff in a vigorous counter-attack. As has been pointed out before, all regulation is politics, and the regulator who fails to recognise this is very likely to suffer.

It follows, therefore, that it is crucial to maintain the cooperation of the regulated sector, while accepting that there will be both miscreants who can be brought back into line and cowboys who require a firm hand. The power of the regulated has always to be reckoned with. The easiest solution is to go in the opposite direction to the formal disciplinarian one and to accommodate the industry. It is exceedingly easy for regulators to be persuaded to do this, with disastrous consequences. Critical engagement with the staff of the regulated entities is much less easy than simple friendliness. Where, for example, an industrial plant has designated managers and engineers responsible for seeing certain kinds of hazards are managed effectively, there will be regular contact with inspectors, and there may be little doubt of the plant staff's goodwill, even if the commitment of senior management is in doubt. The problems posed by limited resources, planning for the future, changes in personnel and so on can be persuasive. At industry level, senior management can lobby senior regulators on how particular issues might best be handled. The offer of collaboration with the agency is immensely attractive.

So much so that Bernstein's (1955) theory of agency capture became accepted wisdom, particularly in America. He maintained that regulatory agencies go through a natural cycle of initial enthusiasm and a desire to achieve substantially improved standards, which is gradually eroded and deflected by the constant reality of working with the industry, until by degrees the agency 'goes native' and begins to think like the industry and adopts its priorities and rationalisations. By this point it is likely to have become dangerously ineffective, no more than a cypher. This process is known as capture.

While capture is a constant hazard, it is not inevitable, and when it does take place it does not necessarily do so on the 'life-cycle' basis asserted by Bernstein. Moran, for example, points out of the Securities and Exchange Commission created to regulate the American financial sector after the great depression of the 1930s:

> At its foundation it was necessarily the prisoner of Wall Street; indeed its first chairman, the notorious Joseph Kennedy, had been one of the main beneficiaries of the age of rascality during the 1920s. However, in the succeeding decades the commission acquired relative autonomy from the markets: it became a prestigiously successful actor in the bureaucratic politics of Washington; it built up a core of able and committed staff; it became itself a major source – perhaps the major source – of information and expertise about the financial markets. (1995, p. 167)

Moran does not explain why the SEC achieved this success. One source is to be found in the considerable range of powers, especially civil and administrative powers, given to it in the legislation: adequate powers are important. Another lies in its regular, though not constant, political backing. American political attitudes to financial markets have long been equivocal: they are a manifestation of American success and free-market libertarian values but they can be brutally destructive of ordinary Americans, as the depression showed. The SEC hence had enough political support over time to use its powers to build, rather than to be reduced to capture.

Braithwaite (1984) tells a similar story of the Food and Drugs Administration in his study of the pharmaceutical industry. The FDA was not, in its early years, particularly effective or feared by the industry, but it did have considerable powers to require safe manufacturing practices, for example, which could impose heavy penalties on recalcitrants. It was through the fighting of a number of battles with major drug firms and the exposing of dangerous products and inadequate research that the FDA built its powers, culminating in the prevention of the distribution of thalidomide in America because of the insistence of the FDA reviewing officer on more tests of the potential of the drug to cause birth defects. In the case of Abbot, Braithwaite showed how the world's largest manufacturer of sterile intravenous solutions was brought into line after a series of failings involving unsafe and contaminated products in the 1960s and 1970s. The FDA prosecuted Abbot, but despite the evidence of non-compliance with agreed manufacturing practices and of non-sterile products reaching hospitals, the case did not succeed. The regulatory costs imposed in the course of the FDA campaign were huge, however. Abbot estimated them at $480 million, far greater than any fine a court was likely to impose. Once again the use of effective powers and the existence of public political support enabled the agency to strengthen, not weaken. The position of the FDA was transformed from the days when a production manager could say: 'You can stand and piss in the batch, and turn around and shake the FDA inspector's hand. He's going to tell you that's not right, but when you go to court they won't find you guilty.' (Braithwaite 1984, p. 376)

Braithwaite's conclusion was that 'clout is what counts' – that is, significant administrative discretion can be used in negotiating with powerful regulatees. His remedy for the potential for abuse of such discretion was a variety of checks on its use, particularly through the medium of publicity. In later writing, he as well his Australian colleague Gunningham, have argued for the establishment of a consumer/trades union public interest or other third-party stakeholder constituency in regulation to act as an in-built watchdog on any tendencies of an agency either to drift into capture, or to use discretionary powers oppressively. There is much to be said for this tactic, which is becoming increasingly prevalent in regulation as it develops, but it is no panacea. The weakness of public-interest representatives is precisely that they are to a greater or lesser extent outsiders. Indeed there is an invidious choice to be made between appointing those with relevant experience, with the risk that it may have made them partisan if, as is often the case, it involved a career in the regulated sector, and appointing outsiders, for example from the consumer movement, who may lack precisely the expertise necessary to identify and attack real misconduct, and may equally be prone to expostulate at situations which, though regrettable, may not be the result of malevolence or even of complacency or incompetence. And public-interest members of regulatory agencies will be members of the boards, or parties to board-level deliberations if separately organised as a public-interest constituency, rather than day-to-day and month-to-month practising inspectors or regulatees. They will in that sense be outsiders and be vulnerable to whatever culture the regulatory regime develops.

As Wilson (1984) points out, other steps were taken to prevent the capture of regulatory agencies in America in the light of an acceptance of Bernstein's depressing theory. Ironically, regulation burgeoned in the 1960s and 1970s, at just the point when faith in its effectiveness was at its lowest, he remarks (p. 211). Thirty-six agencies were founded, increasing the federal budget for, and the numbers employed in, regulation five-fold. Ironic perhaps to an academic observer, but quite the reverse to those involved in the enthusiastic and often radicalised campaigns of those decades, who demanded that industries be restrained from polluting land, waterways and the atmosphere, from killing and maiming employees, and from marketing recklessly unsafe products, notably motor cars (Nader 1965). As Wilson recognises, where the previous generation of regulatory agencies had been concerned with prices and conditions of service and essentially economic in style, the new ones were concerned with long-term consequences and insisted on substantial improvements, both immediately and further over time, with much less regard to cost. What was characteristic of the period was a rejection of the view of regulation that reflected its wholesale capture by industry, the view that not much can be done and more will cost far too much and be impracticable. Political will, in other words, was mobilised, with a determination to have effective regulation. To that end, a number of changes were made in the way the new regulation was set up, some of them disastrous hostages to fortune.

First, targets were established which were deliberately demanding, rather than leaving them to the agencies to set, targets that were 'technologically forcing' beyond current capabilities. Secondly, the new agencies were made part of the executive branch, rather than independent commissions, so keeping them subject to political control. This in turn reflected the surging political confidence of that period that the stranglehold of big business on politics could be broken, and that, once broken, things would continue to improve, the only question being how fast and how radically. Thirdly, agencies were largely given responsibilities straddling industries and sectors, rather than being focused on one and hence vulnerable to capture by it. Finally, public interest constituencies were built into regulation to maintain constant additional pressure and oversight.

In one sense these initiatives were successful. The new agencies, including Environmental Protection and Occupational Safety and Health (EPA and OSHA), were vigorous and quite effective. Because they were tied to the executive, however, they were exceedingly vulnerable when the political climate reversed and Reagan and the new right came to power. Then they could be swiftly downgraded and downsized if not emasculated, their ambitious targets readily identified as oppressive, costly and unnecessary. 'After a decade in which agencies … were vigorously denounced by business for imposing over-stringent requirements on them, the agencies are now denounced for being in bed with the industries they control.' (Wilson 1984, p. 213)

Significantly, one of Braithwaite's conclusions on the FDA was that it owes its strength in part to having complete responsibility for an industry and not having to share it with other agencies, nor direct its energies to other industries. Like the SEC, it is an independent commission. Achieving concentration of power and responsibility in one regulator for the entire sector is now becoming increasingly accepted political wisdom, with the Financial Services Authority in Britain consolidating responsibility for the entire sector, including banking. Similar arrangements have been introduced in Australia in 1998 with the creation of a securities and investments and a prudential regulator. Although a similar outcome looked in prospect for British utilities, it was much less feasible, however. Thus, while gas and electricity might be regulated jointly, water poses different problems, and in any case is subject to the issues of pollution and purity of supply, which involve other agencies concerned with pollution rather than the regulation of a monopoly. Further, all the agencies are subject to the attentions of the Monopolies and Mergers Commission, and power-generation has to deal with nuclear, oil, coal and renewable sources of supply, all of which pose different problems and have had shifting political statuses. The outcome is that many regulatory regimes are necessarily the product, to a greater or lesser extent, of the work of several agencies, which of course makes setting objectives and achieving them more complex and demanding.

Capture, then, is a serious risk for state regulation, but not an inevitability. What is striking in the literature is that, despite much debate on this topic, essentially an aspect of regulatory failure, there is no attempt to conceptualise regulatory success. Much of the research that investigates and reviews regulation that is at least partially successful focuses on compliance and enforcement styles. While of enormous importance (and the topic of the next chapter), compliance is about front-line practical interaction between inspectors and regulatees, and the strategies and tactics employed in getting regulatees to do as they are asked. It is much less about the success of the agency as a whole and of the nature of the regulatory regime, the particular mesh of personnel, resources, powers, policy, institutions and institutionalised patterns of interaction with regulatees that may lead to capture, but may involve success and perhaps other outcomes too.

How do we conceptualise a desirable outcome as regards, not compliance day-to-day and month-to-month with the requests of the regulators, since this begs the vital question of whether these very requests are sufficiently stringent and demanding, but of whether the regulator is captured or otherwise ineffective and of the status of the regulatory regime? If it is captured we might say that it is being led by the nose by the industry: the alternative and more desirable situation is hence one in which the regulator leads the industry. In order to do this it will need adequate powers and resourcing and a clear and appropriate legal constitution, as well a political backing, adding up to Braithwaite's 'clout'. This enables the regulator to command the industry's attention. It does not ensure cooperation. It may very well stimulate resistance, but at least resistance is overt and can be addressed, not only by threat of sanctions, but by more emollient tactics. Provided the regulator acts from a position of strength, it can well afford to engage in dialogue, accommodation and negotiation with its regulatees as a means of bringing them into a cooperative relationship in which they and the agency can agree how to go forward and to achieve objectives that both of them come to accept. The key idea here is engagement. With those who resist there can be negotiations. With those who disengage there can only be formal relations. This lesson is evident in recent work by Braithwaite (1994) on nursing-home regulation. In a methodologically complex paper which there will be no attempt to summarise here, the authors rate nursing-home directors on four scales: resistance, disengagement, managerial accommodation and capture, this last referring to the capture of the regulatees by the regulator, not vice versa. They then measure the likelihood of compliance over time for those coming high on each of the scales. Not surprisingly the captured and the accommodators fall into line. What is more significant is that the resisters attract more regulatory attention, and as a result fall into line in time, while it is the disengagers who after 18 months are most likely still to be non-compliant. 'Whereas resisters erected a social barrier based on political differences that wore down with time, disengagers erected a personal barrier that was more resistant and more damaging to compliance'. (1994, pp. 390–1). 'The challenge becomes not so much how to make it economically rational for the organisation to comply, but how to sustain the emotional commitment to working to achieve the regulatory goals within the regulatory system.' (p. 392)

An account of what is involved in the regulator being in a position to be in the lead, to be seen as a positive source of guidance as well as of negative sanctions for misconduct, as being constructive and expressive of the public interest while alive to industry constraints, pressures and objectives, but not subordinated by them involves the combination of clout and engagement. The regulator which is unable to get its industry or sector as a whole to engage will either succumb to resistance, or be captured, or will fumble in the gloom of disengagement. The term proposed for this positive outcome for a regulatory regime is ascendancy. It involves a relationship between the regulatory agency and its regulatees similar to that between a teacher and a class of students. The process of regulation is a similarly educational one, in the etymological meaning of the word, that is, that the taught are 'led out', that a process of discovery is involved. The difference is that, unlike the classroom, the students are more powerful and in many ways more knowledgeable than the teacher. The teacher's task is similar, however, in exerting moral authority, in structuring knowledge and in directing the attention of the taught to important issues and getting them to understand them. For those who have experienced it, it is rather like teaching mature students, who because of their age and experience, have none of the instinctive deference to the teacher of children, and who may have very diverse views of the significance of their own knowledge. Some may see it as of only limited relevance to what the teacher has to impart, where others behave as though nothing the teacher can offer can truly instruct them. The key problem for regulators, as for teachers, is commanding the active engagement of the taught. Regulatees are just as prone as students to truancy, being bored, becoming hostile and attacking the teacher collectively as a convenient authority target.

Useful as the analogy with teaching is, however, it should not be pushed too far. Regulation is significantly different, both in the power balance between the parties, and very often in the knowledge balance. Although well-established inspectorates, for example, Environmental Health Officers and water and air pollution inspectors (Hutter 1988, 1997; Hawkins 1984) may have considerable expertise and deal with regulatees who have far less, and so may engage in a good deal of actual instruction and, like teachers, use the law and their legal powers as a basis for building their authority, including threatening the recalcitrant with sanctions based more on bluff than real capacity, many inspectorates, particularly those becoming established, do not have these advantages. They may be confronted with regulatees who, both individually and collectively, are highly equivocal about state regulation where they are not actually opposed to it, very clear about their legal rights to resist by negotiation, appeal and litigation, and only too ready to claim that they know and the inspectorate does not. Achieving ascendancy in these circumstances may be no easy matter.

Now that we have ascendancy as a positive objective and capture as an example of failure, we can conceptualise the current state of a given regulatory regime as somewhere on a continuum between the two.

Ascendancy ——————— Capture

We are then interested in what drives agencies in one direction or the other over time, which was the subject of the earlier part of this chapter, though reflected in the peculiar bias of the literature towards capture as a negative outcome. The dynamics of regulator/regulatee interaction may also produce some intermediate states of interest: are there points at which regulators get stuck in their attempts to achieve ascendancy, for example? Points made in the literature as to the resourcing, powers, remit and political, including governmental, backing for an agency are clearly significant conditions of success, and what is vital is the outcome of the interaction between the parties over time. Thus, to revert to Braithwaite's account of the success of the FDA, its willingness and capacity to take on the very large and powerful drug companies and impose sufficient sanctions for plain abuses to command respect and attention were critical. This could not have happened without trained and dedicated staff with the self-confidence that comes from external political support. The outcome was to change the views and practices of the industry as a whole, and for the FDA to achieve ascendancy.

We must not assume that there will always be widespread resistance among regulatees, however, even if that is clearly possible. We also have to take into account how far a regulatory regime seeks to shift industry practice from its current habits and standards and the view of regulation taken by the industry. On the one hand regulatory demands that are modest may be relatively easily accommodated. On the other, even quite stringent demands may be seen as an opportunity if an industry or sector has become severely threatened by public scandal. This argument has been specifically developed by Carson in respect of the British Factory Acts in the mid-nineteenth century (Carson and Martin 1975). Large factory-owners, some of them also MPs or active in the political process, perceived that they not only stood to be morally and politically compromised by grossly oppressive and dangerous working conditions in factories, but also that, if they invested to raise standards, they could drive their smaller competitors out of business because the latter could not afford these costs. A similar argument was used by Kolko (1963) in respect of the scandal which erupted around the Chicago meat-packing industry in the early part of the century following Upton Sinclair's exposé in *The Jungle*. The nuclear power-generation industry now advertises on television the toughness of its standards and the low levels of failure and leakage, and invites sceptics to visit Sellafield 'to see for themselves'. It only embraced high standards and began to court publicity about them because of mounting public hostility to nuclear power following earlier incidents in Britain, America and especially the Ukraine (Chernobyl). Finally, one cannot assume that regulators will be energetic and constructive in developing a regime. Many are, but by no means all. If the regulator makes little effort, then ascendancy will be unachieved and irrelevant. The regulator will not so much be captured as moribund, though the difference between the two will not be great, since the regulatees will be able to do more or less as they wish.

We can go one step further in conceptualising these dynamics by suggesting that there are both vicious and virtuous circles. The virtuous one is probably the more simple and uniform. It begins with the regulator achieving the engagement of the majority of regulatees and then moving to persuade them that broad regulatory objectives must be achieved. This results in the regulator being perceived as an essential source of information and guidance, and this in turn stimulates consultation on developments and potential problems before they become serious. This in turn ensures that the regulator's knowledge of what is going on in the industry is up to speed, and simultaneously ensures that regulatees are informed about the current practical meaning of regulatory standards and objectives. The outcome is an industry-wide culture of compliance and the regulator ascendant, with adequate time, both to devote attention to miscreants, and to ensure continuing ascendancy by regularly reflecting on policy, practice and standards. What is evident in this account is that achieving the first stage, the engagement of regulatees, may well be by far the hardest if they are disposed to resist, since they frequently have ample resources to do so.

Vicious circles are probably much more diverse, but a frequent starting-point is for regulatory objectives to be seen either as confused and unclear, or as unacceptable. This leads to the regulator being perceived as uninformed, weak or wrong-headed and regulatees hence ignore the regulator, disengage and become truculent and inaccessible. Communication hence becomes more laborious and strained, misconduct is concealed and is more extensive by the time it is uncovered, so triggering serious resistance to the potential for sanctioning, and imposing heavy burdens on the regulator in the time taken to sort out individual regulatees. This means not only that there is less time for supporting other regulatees who may be more willing to engage, but, worse, a danger that the regulator will not be on top of new issues as they develop. This will reinforce an impression of being uninformed and weak. Regulatees will then be in a position to attempt to set the agenda and move forward on their terms.

Note that this account, which does pretend to be more than a schematic example, deliberately skirts around the issue of the regulators' powers. It might be thought that substantial powers – clout – would provide a remedy. The point is that they can if used appropriately, but that they have to be exercised to achieve results. If the resistance of the regulatees on a sufficiently wide scale wrong-foots and questions the regulator, rather than directly challenging it (or perhaps even worse, as well as directly challenging it), the regulator may never feel confident enough to use its powers. Confidence will of course also be affected by the degree of external political support it has. Even if it does not assert itself sufficiently to command the attention of regulatees, established resistance and disengagement may sabotage the chances of achieving ascendancy. Like a bolshy class of students, there may be grudging acceptance of the regulator as part of their world, but a constant readiness to dispute points, and a general truculence, founded in a conviction that the regulator is uninformed and does not understand, whereas they, the regulated, do. Unless the regulator can break though this, truculence can become a point on the continuum between ascendancy and capture where regulators get stuck, as we will see in the example below.

The difficulty with examples of regulatory regimes is that all are different and they usually change over time, which means that accounts of their development are inevitably extensive, in contrast to the accounts of compliance which look at control tactics and strategies by agency staff, usually in microcosm and in a timeless snapshot. This makes them much easier to compare and has generated a substantial literature, as we shall see in the next chapter. Besides those examples of regulatory regimes already referred to briefly above, we shall therefore look in outline at two more, one of which exemplifies a moribund regulatory agency and the other the difficulties of achieving ascendancy in the face of resistance and the failure to get beyond truculence.

An Australian asbestos mine: moribund regulation

Gunningham's account of the complete failure to regulate health and safety at an Australian asbestos mine (1987) is helpful in a number of respects. The extent of the failings eventually led to the mine's closure and to a committee of enquiry, which reviewed the entire history of the mine from 1940 to 1979. Although there were features peculiar to the mine which made it particularly vulnerable to lack of enforcement, it also provides an insight into a moribund regulatory regime. The facts are relatively simple. The mine was a small one, employing between 15 and 40 workers, mostly Aborigines, of which four or five were engaged in milling the asbestos, separating it from the host rock, and most of the rest in quarrying. It was the milling process, conducted indoors, that generated the highest dust-levels, which in the case of asbestos is extremely hazardous and required to be monitored and controlled. In the period 1940–58 there are no quantitative records of dust-levels, but former employees reported being unable to see the wall of the mill a few yards away, and shovelling asbestos into sacks unable to see the man holding the sack for dust. A new mill came into operation in 1959 that was less dusty, but as the report commented, dust-control measures and respiratory protection were extremely limited. In 1970 dust monitoring and filtering equipment was introduced, which reduced dust levels and also for the first time gave reasonably accurate counts of levels. The permitted level at the time was 4 fibres per cubic centimetre. The mine management monitored the general dust-level in the mine at 196, and some procedures at even higher levels. Since the owners were major asbestos manufacturers, and knowledge of the dangers of asbestos was established from the 1930s, it was clear that the risks were well-known at the plant, yet management did not attempt to explain them to the workforce, which was hence not motivated to demand better protection. The mineworkers' union took no interest in the dust hazard.

There were a number of factors which conspired to make the mine particularly vulnerable to under-enforcement. It was small and relatively remote. Its workforce was largely Aboriginal, which meant that, during the period in question, the workers were members of an ethnic outgroup of close to pariah status. The hazard posed was principally long-term, in diseases associated with asbestos, which meant that there were no dramatic incidents to command the attention of regulators. Further, medical records of employees and former employees were patchy, and aborigines had cultural objections to post-mortem examinations which would have proved asbestos-related diseases, though cases were identified by X-rays as early as the 1950s. The mineworkers' union was completely ineffective in acting to protect its members. Finally, the mine was only marginally profitable and seen as having a limited life, and this was used by the management as a basis for reluctance to improve dust-control.

This, however, neither explains nor justifies the failure of the regulators to act. True, they were compromised. Responsibility was divided between the mines inspectorate and occupation health and safety. The former lacked expertise in the dangers of asbestos and dust control and were also part of the mines department, which was responsible for promoting the development of Australia's mineral resources, a major source of wealth during the period in question. The mines inspectorate did have significant powers, whereas occupational health had the relevant expertise, but lacked powers of enforcement. The outcome was that not only was almost no monitoring undertaken, but that when it was, it was calculated to produce results grossly biased in the management's favour. Tests were conducted in 1948, 1952 and 1960, and thereafter every two years on average until 1976. The report does not conclude whether the inspectorate knew of the hazards but failed to act, or whether it did not know. Evidence suggests that it may have been the latter. One employee commented: 'In the 25 years that I have been there I have never seen a mines inspector, a health inspector, or anything like that come in for a spot check. You would always get a day or two's notice to slow down, clean up, get everything spick and span and in they would come when it was all beautiful.' (Report 6.13, quoted in Gunningham 1987, p. 79).

Even so, some of the inspections revealed that dust was above permitted levels, yet the regulators' only response was to send a copy of their report to the mine manager and to his head office. The reports often recommended improved dust control, but no attempt was made to enforce this. The committee of enquiry was in no doubt that the regulators had powers adequate to achieve improvements, but they were not used. It emerged in evidence that the mines inspectorate regarded prosecution as counter-productive in diverting the time of inspectors away from the field, in the low level of the fines involved for convictions, and in antagonising regulatees. 'Above all else the inspectorate was committed to a strategy which emphasised the need for consultation, advice, encouragement and assistance, to the exclusion of any form of enforcement action' (1987, p. 81). Hence there was no need for spot-checks, because relations with the industry were collaborative and surprise visits would be liable to be seen as an attempt to catch management out, an unnecessarily hostile tactic. It was not that the regulatees made active attempts to block, subvert or convert inspectors, but rather that inspectors did not see their role as involving more than advice, and made no attempt whatever to achieve ascendancy, or promote and insist on improved standards. Regulation was moribund.

British retail financial investment: truculence

The final example illustrates how a regulatory initiative can be blocked, despite being far from moribund, by the resistance of the regulatees. The regulation of financial services in Britain is an example of the paradox of the deregulatory aspirations of new right governments actually giving rise to further regulation. Primary impetus for regulation came from the recognition that London would have to be more accessible as a financial market to foreigners if it was to maintain its place as the premier financial centre of Europe, as global, constant trading became possible with the arrival of improved communications. Specific impetus to reform was given by the perception that the existing system of regulation was closed, restrictive and anti-competitive. Regulation was conducted in a largely informal, private way, with banks subject to the quite personalised supervision of the Bank of England, and the stock market to its governing council. Membership of the Stock Exchange was not open to foreigners, or to banks, and in practice regulation was mediated by a culture that reflected the privileged backgrounds of leading members, and in particular their private education and Oxbridge higher education. A number of rules on commissions on deals existed, including minimum commissions, and the Office of Fair Trading had begun a comprehensive review of the Exchange's rule book as a set of potentially restrictive trade practices. This process was brought to an end by an agreement between the Secretary of State for Trade and Industry and the chairman of the exchange, by which minimum commissions and other restrictive practices would go, banks would be allowed seats on the exchange, as would foreigners, and the entire financial sector would for the first time be subject to a unified regulatory system, with a state-appointed supervisory regulator, the Securities and Investments Board overseeing a series of sectoral self-regulatory organisations, professional bodies and specialised markets, such as the Stock Exchange and the commodities exchanges (Clarke 1986; Moran 1991). The object of this transformation was to achieve a 'level playing field', that is, regulation of the entire sector by principles, rules and agencies which would be intelligible to outsiders and provide standards of regulation comparable with the best, that is America. This in turn reflected the Thatcher government's belief in the benefits of free and open markets accessible to all.

As indicated above, it was the Stock Exchange that bore the brunt of the conflict over transformation. The price extracted for its agreement was acceptance of a good measure of self-regulation at the front line, as expressed in the range of second-tier agencies which were to conduct their own affairs, subject to the approval of their rule-books by the SIB. This was created by the 1986 Financial Services Act in parallel to, but evidently much weaker than, the US SEC, which was widely debated as an example of an over-intrusive state agency to be avoided. Although there have been problems since, the regulation of wholesale markets has on the whole been successful. Retail markets were also included under the Act, since one of the objectives of reform was to encourage mass participation in the financial markets, which was also promoted by the concurrent series of privatisations of utilities and other nationalised industries. A prime aim of the Act was investor-protection to ensure confidence in the markets. To this end regulation was intended to prevent fraud, to provide, through an investors' compensation scheme, for the compensation of those unfairly exploited, and to ensure disclosure to ensure that all market participants had adequate information to allow informed decisions on sales and purchases. Besides stocks and bonds and those who gave advice on them, unit trusts (mutual funds) were included in the regulation and endowment life assurance, because of its reliance on investments in equities, but not mortgages, despite the fact that homebuyers normally see their purchase as an investment, since house prices normally outstrip inflation, and despite the fact that mortgages are, for all but a very few, by far the largest financial commitment they make. In the same year (1986) the government legislated to liberalise the quite restrictive constitutions of building societies, allowing them to compete more directly with banks, and to convert into banks by demutualising. It also legislated to promote the take-up of personal pensions by offering tax breaks and inducements worth nearly 9 per cent of income for a limited period. The object in this case was, first, to promote greater self-reliance of the population as to long-term financial security, and secondly, to address the problem posed by much more frequent job-change, accompanied by periods of unemployment, which made the traditional solution of occupational pensions less attractive, since employers' schemes were frequently not easily transferable. In practice, it was insurers who were most eager to offer private pensions, and take-up was substantial, far exceeding government expectations (Clarke 1998a).

Less attention was directed at the retail side of regulation, partly because it had not been the driving force of change, partly because it had also not been subject to scandals, which threw existing largely private regulation into doubt in the wholesale side (Clarke 1986), and partly because it was dominated by banks, building societies and insurance companies, many of them mutual institutions with long traditions of paternalism and service and a good track-record of prudential management. To these bodies the element of self-regulation under the Act was taken for granted as the foundation of the way things were to go forward. The chief executive of the Life Assurance and Unit Trusts Regulatory Organisation (LAUTRO), coming from a career elsewhere, hence found himself faced with a daunting task: an industry dominated by a number of large, powerful, well-established and very confident businesses, with a strong belief in the value of their products and that the public were generally under-provided for in terms of medium- and long-term savings and protection (Jebens 1997). They were also firmly of the view that life assurance especially has to be sold, and that the public will not seek it out, and hence maintained large sales forces with high rates of staff turnover, as commission paid sellers faced with constant 'pitching' to 'prospects' rapidly burned out. This system of maintaining maximum coverage of the population was nonetheless believed to be essential to reaching the market and so maximising sales.

Difficulties arose on several fronts. First, the mortgage market became a regulatory nightmare as insurers and lenders realised the potential of linking mortgages to endowment assurance. This could provide commission income for the mortgage-lenders and extra sales for insurers, but it converted a non-regulated product into a regulated one. And as a house-price boom developed in the 1980s, fuelled by the increased public competition in lending stimulated by the deregulation of building societies, lenders competed to offer larger loans faster on more attractive terms, and to create more and more complex mortgage packages linked to various other financial products – Personal Equity Plans and pensions, for example. Secondly, both mortgage-lenders and insurers fell over themselves in their attempts to achieve market-share in a boom that many believed would not only earn them a great deal of money in the short and medium term, but also determine who the long-term players would be. This drive to sell was also evident in the personal pensions market, and despite government warnings that the people with the option of an occupational scheme would normally be better off with it, because of the substantial contribution by the employer as well as the employee, caution was thrown to the winds, salesmen derided occupational schemes and several million people ended up with personal pensions that clearly disadvantaged them.

The overselling of mortgages, often with endowment assurance linked to them, and the mis-selling of personal pensions hence constituted two massive financial scandals in the 1980s and early 1990s that regulation plainly should have prevented. Part of the failure in respect of mortgages lay in their exclusion from the protection of the 1986 Act though endowment assurance was included, and four out of five mortgages were endowment-linked by the end of the 1980s (Clarke 1998a). The sources of the regulatory failure can be seen in a combination of circumstances in which the resistance of the industry to engage with new regulatory requirements was central. The difficulties of the new regulators in achieving control were compromised by the boom, which played a substantial part in hitherto rather staid financial institutions engaging in sustained misconduct, to the extent that almost the entire industry was delinquent. This very fact, however, only served to confirm its truculence. It was not a matter of a few firms behaving badly and others perhaps being reluctant to condemn them, but of household names constantly being told to restrain themselves and to admit misconduct and failing to do so. In the end the regulator introduced an escalating series of fines, but even that failed to achieve engagement. So bad did the situation become that there were two rounds of re-regulating, the first one essentially amalgamating the self-regulatory body for smaller brokers and financial advisers, FIMBRA, with LAUTRO to form the Personal Investment Authority (PIA), and a second one collapsing the two tiers of regulation into one, with the PIA becoming a division of the new Financial Services Authority, which was due to replace the SIB at the end of the decade. Self-regulation was hence progressively removed in favour of full state regulation, though not without sustained conflict along the way, over the formation of the PIA in particular. This involved the clear step in the direction of state regulation with the establishment of a majority of public interest members on the board (though there was vociferous public debate as to what constituted the public interest, since the chairman had been a senior figure in one of the insurance companies criticised for regulatory failings). Some major firms refused to join the PIA and it was recognised that self-regulation under the 1986 Act had gone too far in providing that the SIB had the powers only to recognise second-tier self-regulatory agencies, not to compel people to join them.

Fundamental to this regulatory chaos, however, was the refusal of the industry to engage constructively with the objectives of the new regulation to achieve much improved investor protection by ensuring that customers knew what they were buying. The difficulty that regulation increasingly posed for firms was that compliance with new procedures surrounding sales lengthened an already lengthy process. Buyers' circumstances were required to be fully reviewed in a fact-find, and the seller was required to disclose her status as independent or tied to one company and the amount of commission received in the sale. Sales literature became more and more voluminous and complex as information disclosure was developed as the principal means of ensuring that the customer took an informed decision. Yet sales of pensions and insurance by the staff of the big firms had never taken this form. In the past, staff had a very limited training and quite modest educational backgrounds. It took a great and sustained effort for the PIA to achieve in 1997 the universal requirement for the qualification of all sales staff in the new Financial Practitioners Certificate, modest though its requirements are. Traditionally the paternalism of the firms had extended to the sales process, with customers being discouraged from asking too many questions and being led carefully through a well-rehearsed sales patter to sign the contract. Critical, informed customers were few and far between (and usually took advice from the better independent intermediaries in any case), and were the last things sales staff wanted or could cope with. The outcome was justified in terms of the benefits insurance offers as protection, with any one product being argued to be better than none, and none being the likely outcome unless customers were approached by sales staff. When allegations of mis-selling began to be made, the industry responded with a mixture of outrage and incomprehension. The Prudential, the largest firm (which refused to be regulated by the PIA) denied that it was responsible for any mis-selling, only ultimately to have to make provisions for it of hundreds of millions of pounds. Its eventually more humble response to sustained criticism expressed its views in a telling phrase: it said that it was now committed to a sales culture of farming rather than hunting.

In the end it took successive government ministers, both Conservative and Labour, berating the industry and naming and shaming the tardy and recalcitrant for the pensions mis-selling review process to make any progress at all in achieving systematic redress. Even then, deadline after deadline was missed even for the first tranche of priority cases for review. When these finally looked like being dealt with, a new industry campaign to avoid dealing at all with the rest began to be mounted. All in all, then, regulation in the retail financial sector was dominated by an industry that had an unshakeable belief in its own virtues and competence and was extremely reluctant to be moved in the direction of more accountability, openness and restraint when it came to selling its products. Regulation eventually forced it in this direction, with the regulators getting gradually tougher, with increasing political backing in the process. Even a decade after the start of the regime initiated under the 1986 Act, which came into force in full in 1988, the industry continues to be largely complacent as to its current virtuousness, even if willing to admit some past mistakes, and decidedly truculent with the regulators, constantly seeking to manipulate them by public and private lobbying and to set the agenda for the future. This is not to say that the industry does not produce good products. As with used cars, there are quite a number of good ones to be had if you can resist the blandishments of the salesman.

The truculence of regulatees has had serious consequences for the development of regulatory policy. As a consequence, public scepticism about the integrity of the industry is substantial, while at the same time the industry has been forced to accept an increasingly costly regulatory burden, which has resulted in direct sales forces being drastically cut back and the independent advice sector, after a shaky start, making inroads into the market shares of the big firms (though the better of these also sell their products through the independent channel). Not only has the industry suffered an increased regulatory burden, odium and distrust, falling sales and compensation costs estimated at up to £11 billion, it has also missed out on the opportunity to debate seriously and constructively the difficult issue of the difference between financial advice and planning, and product-selling, and hence to participate in the development of a regulatory framework which would ensure that the public is given sound and objective advice when appropriate, and is not constantly subject to sales pressure, an outcome that would allow the industry to gain respect both for its products and for its contribution to the public good in assisting with medium- and long-term planning in distributing them. Whether the new Labour administration will be able to achieve ascendancy with its consolidated regulator, the FSA, remains to be seen.

Regulating the state: audit and the new public management

The antipathy of the new right governments to the state, which had grown in an increasingly uncontrollable way in the postwar period especially, and threatened to consume, and to be able to justify the right to consume, an ever greater proportion of national income, was expressed in a progressively radical form. Initially there was scepticism at the state's ever-widening role and the imposition of cash limits on budgets. The led to cutbacks in government agencies, including regulatory agencies, in both Britain and America, as we have seen. The technique of budgetary control by cash limits proved effective in relation to past practice: units of the state were told what they would be allocated in a given year as the outcome of an annual public expenditure review in Britain, and this became much less amenable to subsequent renegotiation in the light of pleas of inadequacy and the dangers of loss of effectiveness or service. The technique also stimulated a clear distinction between operational units so that budgets could be allocated to them on a rational and comprehensive basis. Devolution of financial control down the system was an important tactic, widely used, for example, in getting schools to manage their own financial affairs rather than constantly bidding to their local authorities, and then offering them the chance of opting out of local authority control and managing their entire budget themselves.

Financial devolution was also intended to persuade state bodies to be more precise about what services they provide and then to consider ways to provide them more efficiently. The Thatcher government brought in senior managers from industry and commerce to advise on the applicability of business methods to the state sector. The logic of this approach was on the one hand to specify as clearly and completely as possible the services provided and then to seek ways to provide them as efficiently, effectively and economically as possible. This should provide room for 'efficiency savings' in the budget. On the other hand this initiative was linked to a new emphasis on quality of service delivery, with clients and the public coming increasingly to be seen as customers. The outcome of this process was the requirement of state bodies almost to re-invent themselves, make explicit some of what had been tacit, and be compelled to spell out and justify everything they did. In the end there came to be almost no entity, however small, without its 'mission statement', its more extensive 'aims and objectives' demonstrating commitment to 'total quality', and in many cases a slogan emblazoned on its public face – police vehicles, for example – advertising to the public just how it was delivering its services – 'reducing crime, fear and disorder', for example.

This process of financial constraint and 'businessisation' is in itself a new form of regulatory restraint upon the state, and reflected a determination to confront the perceived arrogance and complacency of the state, whose senior figures, the so-called 'mandarins', believed that they and only they understood the true long-term needs of the country, were capable of formulating and implementing effective public policy, and were possessed of a wisdom derived from an ethic of public service, a lack of political partisanship and the experience of outlasting governments, a culture lampooned in the long-running television series *Yes, Minister*. Forcing state units to justify their functions and *raison d'être*, and to specify their services and how they were to be improved and delivered more cost-effectively led to an emphasis upon value for money as the basis for analysing what the state does. The entire process of new public management, both its financial side and its customer-orientated service delivery side, led to two further developments. Units of the state were progressively hived off to become increasingly freestanding and self-financing operations, and so entirely independent of the state. In some cases the process could end up in privatisation with the agencies being sold off. By the end of the Conservative administration in 1997, this process had even reached the prisons, where a programme of state-contracting with private prison-providers was underway and accepted, despite reservations by the incoming Labour government.

On the other hand, a considerable number of agencies began to develop in the course of this process to monitor and stimulate the standards of service being provided and to provide an avenue for public representation and complaint. Some of these bodies had long been in existence, for example the Inspectorates of Prisons and of the Police, given that they constitute the prime coercive arms of the civil power. The Comptroller and Auditor-General's office also existed to oversee the propriety of state expenditure, but this was substantially widened into the National Audit Office, which acquired a very wide-ranging remit to investigate the quality and value for money of many functions of the state, and developed considerable depth of expertise and experience. Its recent enquiries have included a review of the youth criminal justice system, long regarded with suspicion as expensive and ineffective in terms of curtailing crime.

This process of state regulation has now become an essential feature of the disaggregation or balkanisation of the state. Where in the past, centralised bureaucratic control provided accountability, allowing units to manage their own budgets and encouraging them to justify their own existence, with the prospect of moving down a government-established track to complete autonomy, progressively erodes the coherence and accountability of the state as its parts take off to do their own thing. The virtues of a secure, consolidated central bureaucracy are hence lost in a state that, as Rhodes eloquently expressed it, is being 'hollowed out' (1994).

> Bureaucracies have demonstrable political advantages including reliability, predicability, probity, cohesion and continuity. Above all they provide direct hands-on control of services through the hierarchical rule-based disciplinary structure. These characteristics favour intervention. Should any future government rail against the constraints of privatised service delivery systems, and seek to steer, the tool it will turn to is bureaucracy. (p. 151)

The remedy for this danger has been the new state inspectorates enumerated at length by Hood and Scott (1996, pp. 324–5) and summarised in Table 4.1. Albeit some of these regulators are not new, this is a sizeable and largely new constituency. There seems little doubt, despite the forebodings of commentators such as Rhodes that the development of increasingly systematic accountability for the state is a

Table 4.1 Core families of UK public service regulators, expenditure and staff, 1994–95

	No.	*Expenditure (£m)*	*Staff nos (approx.)*
Public audit bodies e.g. NAO	4	140	2500
Central agency regulators e.g. Office of Public Service	4	80	2000
Inspectorates and equivalents e.g. HM Inspector of Prisons	23	70	1500
Ombudsmen and complaints handlers e.g. Parliamentary Commissioner for Administration	17	20	500
Totals	48	310	6500

Source: Hood and Scott 1996, Table 2.

permanent shift in political life, even if a degree of reintegration is undertaken by later administrations. The difficulty that analysts have had, however, is in expressing their objections to the process in precise general terms. Is it objectionable that state budgets and tax money should be scrutinised as to whether they are spent sensibly, effectively and without waste? Is it unreasonable to ask them to say what it is they claim to be doing? Is it unfair to ask them to set themselves standards of service that their public clients may reasonably expect to be attained? Anyone who has been the recipient of state services – in a hospital out-patients department, for example, or as a student awaiting the return of an assignment, or even more baffling and frustrating, making an enquiry as to the current status of a planning enquiry and when developments can be expected – will have sympathy for the requirement for the state to be accountable. Yet talk to anyone subjected to the ever-increasing extent and intensity of the new public management over the past two decades and you will be met with a catalogue of woes. No one understands us, no one gives us credit for our efforts and achievements, all anyone wants is more for less in a shorter time with fewer staff, and then we have no time to do it because we spend our time preparing to be inspected, evaluated and audited, having pointless meetings, drawing up meaningless charts and charters and completing irrelevant statistics. The police, notoriously, have become heavily burdened with this 'form-filling', a product at least in part of the crisis in public confidence in them in the wake of riots, miscarriages of justice and increasing demands for due process for all suspects. Hospitals have been subjected to market principles, with the introduction of a new phalanx of managers determined to make 'users' aware of the cost of every test, every item of equipment and every staff member. It has been loudly bewailed as a process of deprofessionalisation, a systematic attack on the ability worked up over a long period of teams of medical professionals to work together to pull off the collective enterprise involving the extraordinary diversity of services and skills that makes up the modern hospital. Disaggregate them and require everything to be justified and paid for and the centipede forgets how to run. As a more mundane example, the diversion of a proportion of the funding of universities to be allocated on a competitive basis to reflect research excellence was an understandable notion in abstract. In reality it has generated an explosion of publications with increasingly less attention to quality and the judicious poaching of active researchers in order to boost departments' research ratings.

This last example leads to an important point on the consequences of the new public management as a regulatory instrument. One of its objectives has been quite explicitly to increase competition in the state to raise standards – league tables for schools' performance is another example, with the public urged to go for the best for their children and the state mandated to intervene to take over the worst performers. The problem lies in operationalising the rules of competition, inspection, appraisal and audit. The nub of the concern of state employees is that this invariably involves simplification and a failure to recognise complexity and to deal with less concrete matters of quality, for which indicators have to be used. Thus how much an academic publishes is irrelevant to its quality. As has been widely pointed out, one key article or book can be the justification of an entire career if its influence is substantial, as at times it may be. There are no short cuts in terms of quality – refereed journals are subject to cronyism, prestige publishers to academic snobbery. Similarly in hospitals, what does it profit a patient to be treated more quickly if the price is a rushed operation and an early despatch home, leading to complications; iatrogenic illness is a serious enough problem already. And this is without considering the nastier ramifications; some operations are a lot cheaper than others and have higher average success rates and shorter periods of post-operative care. If you are a patient it pays to have one of these afflictions and not one that requires time, ingenuity and a variety of skilled personnel.

The problem, to put it simply, is that many of the new forms of state inspection turn the process of obtaining adequate continuing funding into a game. In order to impress the inspectors, auditors, quality controllers and reviewers, state agencies are required to show that they have been doing well according to externally identified criteria, which are inevitably operationalised through the use of indicators rather than a real measure of quality, even supposing the external reviewers understand the meaning of quality in a relevant agency. Of course there are benefits to this process: an external eye may make helpful suggestions, as management consultants have long demonstrated. Some matters of service delivery do bear specifying – minimum standards are not always impossible to identify clearly, and any organisation subjected to no restraint can develop slackness. The danger arises from the pressures to achieve according to the new criteria. In business, success is sales, and on the basis of them, profitability. The logic is reasonably clear, albeit not as simple as more sales meaning more profit. Business generates its own income: the state does not. The inspection, review and audit process which the new public management has developed has constituted itself as the functional equivalent of sales: prove that you process more, and given that it is a competitive, cost-cutting world, with fewer resources, and like business, your income will continue to flow. As businesses are painfully aware, however, life is not like that. Success has much to do with hitting the right market at the right time with an appropriate product; virtuous efficiency and product development does not always lead to reward. Further, there are few required standards in business. As Gerald Ratner demonstrated, if people want cheap jewellery, it can be provided, but customers only get upset and affronted and stop buying it if you tell them what they are doing. Maintaining quality of service is a prime objective of the state and exceedingly hard to measure externally. The consequence is that those most adept at playing the game set up by the new state regulators and producing results according to their indicators are the ones who are rewarded. In time this can shift the work of entire sectors from being of good quality to looking like a good performance.

In a damning and extensive enquiry into the use of audit in particular as a regulatory instrument especially in the public sector, Power (1997) develops this point further. He points to the externality and, it should be added, lack of engagement of auditors with auditees and their constitution of audit as a world in itself separated from reality, 'a rationalised ritual of inspection', which 'concerns itself with the auditable form rather the substance' (p. 96). The additional danger of audit, he points out, derives from its very popularity and the increasing reliance placed upon it, which he documents at length. As with company audits, on which he has equally grave reservations, the hazard posed is not just that they do not achieve what they claim to, but that they give a false sense of security. Since audit is required, authorised, organised, paid for and professional, and since it is increasingly the sole official source of review and approval, it is relied upon. It is for this reason, as we saw in the last chapter, that companies cultivate their auditors to an extent which inevitably compromises their independence; the board needs the auditors' seal of approval that its published accounts are 'true and fair', since this then contributes to public and shareholder confidence in the company.

In the public sector where it is linked to funding, things work somewhat differently and Power identifies two reactions. The consequence of auditing and other new public management regulation may be decoupling, that is, the audit becomes a game to be played entirely separately from the real job of the work of the state agency, a ritual to be undertaken competently. This encourages cynicism and game-playing, and in due course the deliberate development and manipulation of audit techniques in order to 'win'. Thus, some universities have been accused of hiding poorly performing researchers to avoid including them in a department, and even of creating spurious departments out of a group of good performers in order to achieve an additional good rating. The outcome is that the audit less and less reflects actual quality. The opposite reaction is colonisation, whereby the game becomes reality and auditees come to inhabit the world constructed by auditors. The symptoms of this affliction are normally the speaking of a new language, replete with the rhetoric of the relevant sector of audit and regulation. Usually it is only a limited number, or particularly vulnerable sectors, who succumb, but they may come to have a prominent or even a dominant role, because they have the capacity to impress the regulators and to present the agency's case for funding. In time the entire institution can be colonised, as those who speak the new gobbledegook come to believe in it, new entrants are indoctrinated, and older hands retire early in droves.

While public-sector regulation is hence likely to survive, it is questionable whether it will do so in its present form, which owes a good many of its weaknesses to the belief that there is no limit to the extent to which it can benefit from the introduction of business methods. Only when this myth is not only questioned, as is presently happening, but replaced by an alternative more appropriate to the public sector, is such regulation likely to progress in its effectiveness.

5 Compliance and Enforcement

Compliance and the enforcement patterns used in attempts to achieve it have been major themes in research on regulation, particularly that now-substantial body of work which has been concerned with health and safety, environmental pollution and the regulation of hazardous industrial processes. Although there are important variations, these share significant features: the regulation of largely material hazards by substantial agencies mostly with relatively long traditions, addressing problems which, though they change as industries develop, also involve well established hazards. Agencies and their inspectors hence face the difficulties of keeping all their regulatees up to standards and researchers have focused on how this can be achieved over time with regulatees who present a variety of different faces: cooperative, antagonistic, recalcitrant, incompetent, for example. Most of these studies hence address 'normal regulation' (cf. Kuhn's normal science), that is, regulation which is established, investigating in considerable empirical detail how agencies achieve what they achieve, which may or may not be substantial compliance, what techniques are employed and what constraints limit them.

Compliance therefore refers to several different features of the regulator/regulatee relationship. Most evidently it involves the agency getting the regulatee to do what is asked, to comply, but this immediately raises a catalogue of issues that are at the heart of this literature concerning what the inspector believes it is reasonable to ask for in the light, not only of her powers and resources (notably time), and of established law, regulation and standards, but also of her understanding of the capacity and willingness of the regulatee to comply. And when the demand is made, perhaps after a formal periodic inspection, announced or unannounced, when is the regulatee supposed to achieve compliance? This raises a second meaning of the term. After an inspection the inspector(s) will identify what they want done in order for the regulated entity – a factory, a nursing home – to come into a state of compliance. This may involve very little in terms of numbers and significance of items, or it may involve many, and include major undertakings involving time and money for the regulatee. The inspector hence has to decide how to pitch what practical compliance means. This can be done by a formal legal notice requiring specified matters to be attended to by a certain date or before machinery is operated again. At the other extreme it may only involve an informal conversation along the lines of: 'I'd like to see that dealt with by the next time I come round. You need to secure that guard rail immediately. You should be aware there are revised regulations coming through for this discharge and you need to be addressing that by next year. You can contact me to discuss what is needed when you see them, but I think you will need to do *x* and *y* given the nature of this plant and the age of this equipment.' The aim of the inspectorate is, in each case, to get the regulatee into a state of compliance, that is, up to standard in all significant respects, but what this means in practice will depend on how stringent the legal requirements are, the inspector's view of the hazards, and his appraisal of what is achievable.

Clearly inspectorates cannot function at all effectively unless most of their regulatees are either in compliance or on the way to it, because all or almost all inspectorates have very limited staffing and funding in comparison to the regulatees. We will come to the use of sanctions below, but there are a number of obvious reasons to keep their use limited, at least over an extended period – it may be necessary to sanction widely and severely to bring an industry into line, as happened with British retail financial services in the 1990s. Formal sanctions are not only time-consuming for the regulator and usually expensive, but often stimulate an antagonistic and defensive response from the regulatee and turn the entire process into a contest to see who 'wins'. The only thing that certainly does not win in the course of this is the regulatory objective. The chances of making progress with this are much greater if the relationship with the regulator is cooperative – compliant – and better still if the regulatee has come to share the regulator's objectives, as opposed to just accepting that what the inspector asks for 'had better be attended to to avoid trouble'. This latter situation of shared objectives, if it exists on a wide scale in the sector regulated by the agency, reflects the agency's ascendancy. Compliance is concerned with more immediate and detailed matters, and it evidently involves the effective management of the relationship between the two parties so as to achieve the best practicable results over time. It is to the skills deployed in managing this relationship that much of the compliance research is directed, with the implicit question: given that most inspectors operate under substantial restraints of resources and powers, how do you get the best results, the most compliance?

Also implicit in most of the research is a respect for the skills, effort and experience of the inspectors studied. Serious questions are hence not pursued of whether what is being achieved is adequate: rather, the focus is on how inspectorates have achieved what they have. Once again this reflects the established character of the agencies studied. In financial services, by contrast, compliance is construed by regulatees in a quite different fashion. Firms of any size have developed increasingly substantial internal compliance departments to ensure that regulation is respected. Even if the compliance officers are no longer routinely referred to as 'business prevention officers', it is still the case that compliance is seen as a set of hazards to be avoided. Compliance officers studied by Bosworth Davies 'all were of varying shades of the same opinion that their function was to protect their employers from being hampered by over zealous regulatory interference and to facilitate their employers' creation of profit and maintenance of market share' (1992, p. 40). Compliance is very widely understood in the financial services industry as risk-management (Adams 1994; Clarke 1995a) and the relationship with the regulators as one of well-informed negotiation and doing what is necessary, rather than willing and cooperative compliance. There is an emphasis on compliance as a state in which all the relevant boxes have been ticked and the regulatee has a clean sheet. The relationship between regulator and regulatee is assumed to be, if not overtly antagonistic, at least arm's length, and to involve explicitly competing objectives: we want to sell as many of our products as possible, regulation hampers this. In contrast, in a materials-processing industrial environment it is very much less easy for regulatees to view hazards in this way because they involve risks of death, injury and disease for employees and members of the public.

Nonetheless, very similar problems arise, as Hutter documents. In developing an account of the practical meaning of compliance, she contrasts 'unacceptable compliance' and 'acceptable non-compliance'. She offers two kinds of examples of the former. First

> when the letter of the law but not the spirit of the law is adhered to. A typical example of this is the case where a factory inspector visited a small metal finishers which had been required to obtain a cyanide

> antidote kit. This had been done, but no-one at the site knew how to use the kit. In this case the inspector arranged for a nurse from the Employment Medical Advisory Service to visit the site and instruct staff. (1997, p. 81)

Note the nature of the problem here: the risk of cyanide poisoning was seen as remote by the regulatees and they therefore did not bother to learn how to react in a case of disaster. The remedy was simply to teach them. There is no implication that they actively resisted the provision, as for example financial services sales staff routinely resist disclosing that they are tied to one company, how much commission they earn from a recommended product, or the need to enquire into the customer's job security when recommending an insurance policy based on regular premiums (Clarke 1998a).

Hutter's other kind of unacceptable compliance

> existed when the minimum standards laid down in the legal and administrative definitions were met, but the inspector felt that a particular company could easily achieve more.... Industrial air pollution inspectors dealing with an asbestos stripping firm were particularly stringent in their demands. Indeed they demanded that all types of asbestos be treated with equal caution, despite the fact that the most stringent standards and procedures applied only to blue asbestos. (pp. 80–1)

Here the inspectors were pushing their own definition of compliance, not least because in the future the firm might be involved in stripping asbestos presumed to be white, but which turned out to be blue or to include blue.

The reverse of unacceptable compliance is acceptable non-compliance, where the goodwill of the regulatee is accepted as a basis for tolerating non-compliance, at least temporarily. Thus meat-cutting band-saws were tolerated in breach of the Factory Act (p. 81). More substantially, local authorities widely tolerated Sunday trading in England and Wales in categories which were illegal under the prevailing complex legislation because of the gathering momentum of public sentiment in favour of ending restrictions on Sunday trading, which gave rise to legislation in the latter 1990s. In general factory inspectors' approach

> will be determined by an aggregation of a site performance across the full range of health and safety or environmental requirements. For example a factory inspector on a check visit to a packaging

> company found that many of the improvements requested by the inspectorate had been met, but one or two matters were still outstanding. The inspector's response was advisory and educational, because the improvements to date had been well done and signalled progress. (pp. 82–3)

In some cases, then, a spirit of willingness – cooperative compliance – is recognised to be the objective of inspectorates and defensive compliance, which lacks it, will lead to a tougher regulatory approach. Where, as in financial services and on the financial side of industry, compliance is widely seen in defensive terms, expertise may be deployed quite extensively. Thus, it is not just financial services compliance officers who see their jobs at least substantially as protecting their employers from the regulators, but also lawyers and accountants who are used 'creatively' to find ways round the restraints imposed by regulation (McBarnet 1992; Smith 1992). This is not to say that problems of duplicity and manipulation do not arise in materials-processing industries – we shall see that they do – but that the way in which compliance is construed in general seems to be different. This leads to the question of how compliance is to be obtained, a matter which has given rise to a long debate about the most appropriate and prevalent strategy for doing so.

Although presented in a variety of different terms (e.g. Reiss 1984), the main alternatives that have now been widely researched are the coercive and the persuasive. The essential contrast is between the use of compulsory sanctions to get regulatees to come into compliance, as opposed to the attempt to convert regulatees to a genuine commitment to the goals of regulation so that they will need no more than advice on how to comply. Actual outcomes are, not surprisingly, usually somewhere between the two poles, and practice will also vary at times as between different regulatees. As we come to unpack what is involved in the two strategies the need to employ elements of both will become evident. At the same time the persuasive strategy is the most satisfactory, precisely because it does involve the voluntary commitment of the regulatees to the goals of the regulators, and hence the willing diversion of resources to that end. The difficulty with the persuasive strategy lies in its emphasis upon sustaining the positive relationship between the two parties. If being 'reasonable' and not making 'excessive' demands of regulatees becomes a major preoccupation of regulators the danger is that they will be drawn too close to the regulatees, sympathise too much with their circumstances and constraints, and be too accommodating, and hence standards achieved will be low and there will be danger of capture in the longer term. Conversely, however, the danger of the coercive strategy is that relations between the two parties become entrenched and antagonistic, with regulatees only ever doing what they are specifically required to at any given time, never divulging information willingly and always demanding attention. Standards may hence end up equally low as inspectors struggle to drive regulatees forward, and are constantly delayed by the need to justify every request at length, and probably face substantial problems of wilful non-compliance that need more time in active pursuit than is available. Maintaining both independence and the moral commitment of regulatees to regulatory objectives is hence a delicate task at the practical level, the direct counterpart of ascendancy at the industry level.

The contrast between the two strategies can be most clearly seen if some of their features are set out. The following list does not pretend to be exhaustive, but it is drawn from the research literature. The polarisation used to construct it is, while not artificial, less than the whole story, as we shall see.

	Strategy	
Coercive		Persuasive
	Techniques	
Enforcement		Information and Advice
Rules		Principles
Verification		Trust
Command Regulation		Self-regulation
Reactive Regulation		Proactive regulation
Penalties		Incentives

The first contrast, between enforcement and advice-giving, has largely been covered above. The resort to enforcement does not preclude the giving of advice, since one objective of enforcement is to create a desire to avoid further proceedings, and advice on how to achieve this may well be offered. Conversely, a regulatee who is generally compliant may still be subject to enforcement in the event of a serious failing, both because the inspector believes that there is no alternative given the seriousness of the infraction and as a warning that being Mr Nice Guy does not involve the toleration of significant abuses and failings. We shall come below to the factors which influence a resort to enforcement.

The use of rules rather than principles closely reflects the dilemmas of the struggle for control. The advantage of precise and extensive rules is that non-compliance should be evident and hence enforcement flow easily. The dangers with rules are that they invite creative interpretation and claims that the conduct complained of does not really fall foul of them. This is partly because it is impossible to devise rules to cover every conceivable case, and in industries which change quite rapidly this means that rules devised with circumstances prevailing at a given time in mind may well work quite well for a while before becoming increasingly anomalous. Rules not only invite challenge: they are also liable to ineffectiveness and irrelevance, which in turn will encourage regulatees to view those who seek to apply them with contempt (Baldwin 1990). Principles have the opposite virtues and vices. They are much less prone to irrelevance, but much more open to debate, including genuine debate as to the meaning of a principle or, more problematically, what several perhaps partially competing principles mean in practice. While enforcement for their violations is hence quite possible it highlights the coercive power of the regulator and its discretion to enforce. While principles are a useful tactic in trying to get everyone to agree, they are the start of a process leading to ascendancy, not the end of it: they have to be followed by practical debate on their application, which also ends in agreement.

Just such a problem arose in the development of financial services regulation. The first chairman of the Securities and Investments Board oversaw the writing of very detailed rules for each of the self-regulatory organisations, which the SIB had the power to approve or reject. The tactic hence maximised the SIB's control in the opening period of a new regime, when new standards were being sought. The industry, however, found the rules irksome and objectionable in a number of ways. First, they became extensive and hence a burden to become familiar with. Secondly, arguments began to develop as to what they meant in particular circumstances, leading to revisions, clarifications, and of course extensions of the rules. Thirdly, they were held to be a violation of the principle of self-regulation enshrined in the Act. How could there be practitioner-based self-regulation if everything was governed by an SIB-vetted rulebook? The second chairman of the SIB, responding to industry representations therefore agreed a switch to principles. The objective of this, as Black (1997, pp. 100–1) points out, was: 'to change the attitude of the regulated towards the regulator, to resolve the tensions between certainty and flexibility, to create and develop an interpretive community between regulator and regulated'. The chairman identified five merits of principles:

- Consistency and cohesiveness in the standards applying as a backbone which draws the rules together.
- Intellectual rigour on the part of the regulators in ensuring that the new requirements really are justified.
- Practitioner understanding and support for the provisions made.
- Emphasis on the spirit rather the letter of what is prescribed.
- A dynamic quality in the rulebooks, enabling them to apply to new situations without constant reformulation' (cited in Black 1997, p. 101).

Creative compliance was a specific target, and the hope was that practitioners would largely be brought on-side so that cooperative rather than antagonistic regulation would ensue. The danger was that the debate on what the principles meant in practice did not yield fruit and lead to a culture of compliance, but that the move itself was seen as a victory for the principle of self-regulation on practitioners' terms, that practitioners know best, and that the role of regulators is merely to stimulate debate on new issues. Arguably the outcome was a degree of success on the securities and wholesale side, but failure on the retail side. As illustrated in the previous chapter, the major players were in no doubt of their prerogatives, pre-eminence and benevolence, and responded with anger and dismay when this was questioned. The result was that the self-regulatory element in the regulation was progressively dismantled, and replaced by more directive and state-managed regulation. The industry, at least on the retail side, came finally to welcome this, since at least it signalled an end to their constantly being criticised for getting everything wrong – both their conduct, and the rules and principles by which they justified it. (Clarke 1998a)

Principles were not abandoned; rather their interpretation and application were tightened by the increase in state direction and control. This did not result in capitulation by the retail industry, however, but now their position was clearer and they awaited direction by the regulator in the knowledge that the new government was keen to see them prosper as a major national industry, and also wanted to use them as part of its aspiration to solve the problem of long-term financial security for the population. The conditions may have been laid for an 'interpretive community'; agreement on interpretation was a good way off.

Trust, which with verification forms the next pair of techniques, has already been discussed in earlier chapters, and its importance has been implicit in this one, as in the last. Successful regulation and genuine (collaborative) compliance must involve trust by both parties: by the regulatee that the regulator will provide appropriate advice and not request unnecessary action, and by the regulator that the regulatee will not abuse that trust by failing to achieve agreed standards. While there may be simple cheating, the notion of calculated deceit, winning the inspectors over with smiles and prompt compliance and then minimising any costly input and lying about it, is alarming but unlikely to be widespread. Much more likely is the potential for changes in personnel at various levels in the organisation over time to lead to changes in attitude. Understandings reached with one set of managers as to the explicit and implicit conditions for trust, leading to less frequent or detailed inspections, may be complete because they arise out of an extended experience of regular contact. Newcomers in the organisation who inherit the trusting relationship may experience things differently, and simply be unaware of the dangers they run in not living up to the agreed standards, in terms of the consequences of regulatory failure to the organisation's public reputation, in terms of its financial liability, and in terms of the subsequent wrath of the regulator, who may be disposed to take public and humiliating enforcement action. Given that trust needs to be constantly maintained in any relationship, and that it is a normal feature of regulatory relationships for there to be an inherent incentive for the regulatee to backslide, trust needs to be actively supported. Part of this will come from the continuing flow of advice and constructive engagement with the regulator – trust should never involve simply abandoning the regulatee on the assumption that he is 'a good chap'. Part should also come from objective verification, so ensuring that, on the one hand, the regulatee is reminded of the power and requirements of the regulator, and on the other hand that the maintenance of standards is an attested fact rather than, as can easily happen, an assumed accomplishment. To take a simple example: does everyone know what to do in case of fire in a building and can everyone leave in a safe period? Most people assume the answer to this is affirmative, but the only proof is in a practice evacuation. In an acute analysis of the role of trust, Braithwaite and Makkai develop this line of argument further.

> Regulatory institutions should not be designed to work well with the quantitatively revealed average case … bad single cases of abuse of trust can have truly catastrophic consequences – the nursing

> home that causes 20 deaths; the nuclear plant that destroys an ecosystem for centuries. Also, such cases can undermine perceptions of fairness, and therefore commitment to the rules among the trustworthy. What is needed therefore is a regulatory strategy that combines a preference for trust with an ability to switch to a policy of distrust … [This] enables regulators to try trust first and then escalate up a pyramid of more or less interventionist regulation if abuse of trust occurs and persists. We are not attracted to the approach of using objective indicators to allocate organisations to those it is best to trust and those it is better to distrust … [because] (a) not least in this research project [on nursing homes], the predictive power of objective indicators of trustworthiness is limited, and (b) our qualitative fieldwork suggests that untrustworthy actors have multiple selves – trustworthy selves that can also be brought forward by respectful treatment.
>
> In considerable measure then, effective regulation involves a policy of keeping trust in the psychological foreground, while distrust looms as a structural fact in the background. The aphorism coined in the Cold War to characterise US strategic negotiation with Gorbachev captured well this sleight of hand: 'trust but verify'. That is, it would have been a mistake to have dealt with Gorbachev as if he were untrustworthy, and it would have been irresponsible to have failed to monitor abuse of trust and to have been unprepared to respond to such abuse. The regulatory state does best at securing compliance when it eschews threat, treating citizens as trustworthy. Yet when the corporate citizen contemplates abuse of trust, it looks beyond the demeanour of trust to see an image of state invincibility. (1994, p. 9)

The authors go on to offer a solution to problems of trust where the regulator may become weakened, corrupted or captured, and where no definitive solution is offered, by having a supervisory regulator to avoid this. This involves establishing a third party stakeholder representing the public, clients or employees, for example, with separate interests to both regulator and regulatee, but an interest in seeing standards maintained, to act as a guardian of both parties. Not the least of the powers of such third parties is their capacity to go public and reveal failings. It is hence vital that membership of regulatory bodies does not involve a formal or informal vow of silence, and indeed the entire process of including third parties should have the effect of opening up regulation to public inspection and comment, albeit that a degree of discretion and confidentiality, at least for certain matters, will be necessary to the maintenance of trust.

In the light of the role of trust and verification the next pair of techniques, command regulation and self-regulation, becomes easier to appraise. These two have often been seen, particularly in Britain in the 1980s, as an important polarity, with command regulation epitomising the overbearing, intrusive state and self-regulation the well-informed and largely well-intentioned regulated industry. It was this sentiment that informed the three-tiered structure of the Financial Services Act 1986, with the Secretary of State (later the Chancellor of the Exchequer) at the top, the state-appointed SIB below, and the self-constituting sectoral self-regulatory bodies at the bottom (Clarke 1986; Black 1997). At the same time research showed that the regulator seen in Britain as the model of state instrusiveness, the SEC, relied substantially and inevitably on a measure of self-regulation (Shapiro 1984). Command regulation and self-regulation hence have an ideological and a practical meaning. Ideologically, self-regulation is associated with the drive for deregulation by new right governments – to put the matter in the terms of the previous pair, the need to trust business more and verify less. Practically, the imbalance in resources in most areas of regulation means that some self-regulation is inevitable. As has been argued in earlier chapters, it predates state regulation. Command regulation is hence often a matter of insisting on higher standards and spelling out practical requirements. Thus Hutter's research on health and safety regulation and pollution is replete with references to laws, and regulations made under them, that specify requirements for safety in a comprehensive range of industrial settings. Command regulation does not just boss regulatees about, it also tells them what they need to do to mitigate risks. Its ideological face as aggressive and intrusive may hence not be manifested in practice, though that is a matter of balance, to which we will come below.

Self-regulation, if it is to be accepted as an important tactic by a given agency, requires not just monitoring as to its effectiveness and advice on the targets to be achieved, but a cautious appraisal of the incentives for it to be effective. It is only too easily taken as a licence for complacency and the gradual development of the view that 'if we are doing it this way, then it must be right' (cf. 'if it's good for General Motors it's good for America'). On the other hand, if a regulatee or a group of regulatees is genuinely seized of the benefits of raising standards and being seen to do so, self-regulation can become a driver for improvement. There are obvious market advantages in being seen to exceed required standards and to be a market leader in quality, reliability, safety and so on. Even though this will involve additional costs it may be possible to more than recoup them through branding and exhorting the public to 'insist on the real thing'. Self-regulation may, therefore, be harnessed to achieve higher standards in certain circumstances, but any state agency would be well advised to investigate carefully before allowing it to develop as a leading technique, and to be certain that the regulatees are genuinely committed to making the necessary effort and willing to maintain full communication with the regulator while doing so.

Some writers, notably Braithwaite (e.g. 1982) and Sigler and Murphy (1988), have argued the merits of the deliberate use of self-regulation, subject to effective oversight. The argument, which is persuasive in the cases used as examples, is that allowing regulatees to set their own standards gets round the problem of applying state standards, often expressed through general rules, to regulatees who may maintain that they do not apply properly to their cases. Further, if regulatees are allowed a substantial input, and agreement is reached with the inspector on the detailed way in which regulation is to be applied, there will be ownership of the regulation by the regulatee, no room for argument about capacity or need to comply, and hence practical compliance is likely to be quicker, easier and more persistent. Braithwaite's research on the American coal industry provides excellent examples of how this tactic can be effective (1985). Variations in geology – the thickness of the seam, the presence of water, the strength of the host rock, the angle of the seam and so on – mean that making a particular operation safe, for example by having a given number of pit props per square yard as regulations require, is often inappropriate. Far better to negotiate safe working with the pit management, agree what is required, and that any changes in the geology as the mine is developed are subject to consultation. The results, claims Braithwaite, are not only better levels of compliance, but improved accident rates. In other industries, however, the scope for practical self-regulation may be less. Manufacturing industry usually develops standardised processes which remain unchanged for quite long periods. The benefit of a self-regulating element in these more stable environments comes from the potential it has for encouraging regulatees to develop new and better means of achieving the same or improved standards. Inspectorates who remain committed to standard practice because it is tried and tested will then be in danger both of failing to achieve improvements, and of beginning to antagonise regulatees, because both their good intentions and the potential for saving time and costs are rejected. In practice, the continuing pressure of costs and the imbalance of resources between regulatees and inspectors will often mean that regulatees take the initiative.

The inspectors then have to judge whether this is an innovation with potential for real improvement to everyone's benefit, or a mere ploy to cut time and costs which compromises the security of standards. What remains important in this tactic is therefore that self-regulation should not be seen as an acceptable recourse in its own right. To work, it needs to be mandated, that is, subject to careful state appraisal and oversight.

The next pair of techniques, proactive and reactive, are somewhat different to those considered so far, in that one, proactive, is preferable in principle to the other. If an inspectorate can raise standards sufficiently to ensure high levels of compliance and vigilance and the lively voluntary cooperation of regulatees, there should be very few, or indeed no incidents requiring reaction. In practice this is unlikely in most sectors, though there is considerable variation. Thus Hawkins (1989) contrasts the construction industry, which is highly dynamic, with changing personnel and new sites constantly being built, and high rates of accidents, both serious and minor, with the chemicals industry, which is stable, has highly controlled and usually well-understood processes and low rates of accidents, but a risk of catastrophe. Inspectors will hence constantly be attending to incidents in the construction industry, and their proactive work will often be fitted in after dealing with an accident. In the chemical industry, by contrast, almost all their work may be proactive, constantly checking to make sure systems are in place up to standard to prevent a major leakage or explosion. In other industries incidents may be less evident. Motor vehicles passed as safe by manufacturers or in annual checks may have defects, but as the regular recalls by manufacturers of cars and domestic appliances illustrate, safety failings often do not give rise to accidents, even though it may have been an accident or series of accidents which led to the identification of the failing, as in the notorious case of the Ford Pinto (Punch 1996a).

In other cases incidents and accidents may be even less evident. Thus the extent of abuse of customers in mis-selling financial services products, notably pensions, in Britain in the 1980s and early 1990s had not been discovered by the level of complaints by customers. Even those whose plans had matured would in most cases be in no position to know that they would have been better off in an occupational scheme and should never have been sold a private personal pension. It was a combination of press comment and investigation and regulators' inspections, initially announced and later also unannounced, coupled with an increased insistence on an audit trail, that began to uncover the evidence. The full extent of the abuse only became clear gradually as a review of all pensions sold in this period was required, and regulatees were required to show that their customers had not been disadvantaged (Clarke 1998a). Was this reactive or proactive regulation? In respect of the identification of a major problem, mis-selling, and the mounting of an ever wider campaign to identify its extent, eradicate it and insist on the provision of remedies, the regulators were clearly desperately running from behind. As regards the style of the investigation necessary, however, it was largely proactive, though number of companies were sanctioned for failure to comply after a second visit when they had been shown to be failing at an earlier one.

In general there is likely to be a balance, variable over time and between sectors, between proactive and reactive work by regulators, with reaction to incidents, accidents and failings being more public and more likely to attract sanctions, and the reappraisal of the trustworthiness of the regulatee, both in terms of commitment and competence. Hutter's conclusion nicely summarises what is probably the situation in many more fields than health and safety.

> A range of information was accumulated during the pro-active monitoring of regulated sites. This ranged from information about technical and financial aspects of a business to inspectors' impressions about the levels of confidence they held in management. Pro-active visits by inspectors and sampling teams were as much symbolic as substantive, representing the visible presence of state officials actively surveying regulated sites and increasing their knowledge of the population subject to control.
>
> Pro-active work was valued by field staff, and pro-active methods of monitoring compliance were regarded positively because of their preventive role. By comparison, reactive work represented the negative side of the job to the extent that it entailed dealing with cases where something had gone wrong or failed. But regulatory agencies had to be responsive to complaints and accidents; not only did they provide valuable information for the agency but ... accident and complaint notes informed routine monitoring programmes. (1997, p. 126)

The final pair of techniques, penalties and incentives, are, if construed as the classic carrot and stick, evidently jointly more effective than would be reliance on either one. Certainly it has been widely argued that over-reliance on penalties in regulation is likely to alienate and antagonise regulatees and lead to a combative relationship, in which the regulatee deploys all his resources to escape both sanction and compliance, and the regulator is constantly citing violations, serving improvement notices and launching prosecutions. The police come closest to this mode of operation, and even they engage in a great deal of advice and negotiation as well as prosecution. It follows from much of what has been said in this chapter and the last that compliance is most likely to be achieved by cooperation and engagement, and that frequent use of sanctions is testimony to a failure to achieve compliance. On the other hand, a total absence of sanctions is more likely to reflect a weak and ineffective regulator than comprehensive compliance, at any rate with significant standards, as the Australian asbestos mine described by Gunningham (1987) attests. Does this then imply that incentives should be used as the preferable alternative? To construe the polarity in this way is to fail to understand that at the heart of real compliance lies the intrinsic reward of the committed regulatee. Full, voluntary and comprehending compliance involves an appreciation of just why regulation and compliance are necessary, and hence not only a commitment to ensuring that standards are met, but a satisfaction in doing so. It is the opposite of the regulatee who sees all compliance as an irritant and a cost to be dealt with and minimised. Genuine compliance is then an incentive in itself, not least in the sense of security it gives the regulatee that things are unlikely to go wrong, and that if they do it will not be for want of appropriate effort. This of course leads to inspectors being likely to take an understanding and lenient view if there is a failure, with the result that sanctions will be less heavy.

It is at root for this reason that Grabosky (1995) is cautious in his review of the potential for the use of incentives in regulation. He considers both material incentives, such as tax incentives, subsidies to promote new and improved technologies, and deposit refund systems, and symbolic incentives, such as public awards for good conduct, but concludes that they should be used sparingly. Material incentives by definition are costly and symbolic ones easily devalued if over-used. There is also a risk that incentive schemes can become perverse, for example a household refuse scheme that allowed a given number of sacks of rubbish to be collected in a year, with any savings on that number redeemable for cash, acted as an incentive to cheat by disposing of rubbish by incineration or illegal dumping. It is important, Grabosky points out, that regulatees should not be given additional rewards for doing what they should be doing in any case. Incentives are hence best confined to rewards for exceptional effort, and for the promotion of new techniques for a transitional period. In so far as they contribute to the building up of confidence and support for regulatory objectives they can be helpful. In so far as they are used as a substitute for sanctions – the mirror-image of penalties – they risk themselves becoming the objective rather than compliance, and undermining genuine support for regulatory objectives.

Two conclusions may be drawn from this brief review of the coercive and persuasive strategies. First, although it has been subject to extensive debate, the weight of the evidence confirms Reiss' (1984) view that the persuasive is likely to prevail over the coercive, partly because of the impossibility of using coercion extensively enough to achieve success given the imbalance of resources between most regulators and regulatees, and more fundamentally because of the difficulty in translating most regulation adequately into formal, practically measurable criteria. Like most managerial and professional work, regulation requires an active input from the regulatee to be effective, and achieving this moral basis for compliance, as Etzioni referred to it long ago (1964), is what the work of most regulatory agencies consists in. At the same time the same imbalance in resources, together with the incentives inherent in most regulated areas not to comply – it is cheaper, quicker, more profitable, and so on – imply that a capacity to coerce must be available and must be used: in Braithwaite's phrase above, the image of the invincible state is essential. This in turn means that practical regulation will be needed, first, to be able to switch from one of the persuasive techniques to one of the coercive ones as circumstances and the demeanour of regulatees require and, secondly, that just as a hierarchy of increasingly formal and painful enforcement is necessary, as has been argued in the previous chapter, so a hierarchy of different styles of regulation is called for in response to more intractable situations.

Such a hierarchy is much less evident with the coercive than in the persuasive strategy, since it is enforcement-oriented. Regulation will consist in responding to incidents of verification by inspection and other means, and for the formal application of rules, with the immediate imposition of penalties for infractions and regular formal notices requiring specific compliance by a given date. The coercive strategy is much more likely to involve recourse to prosecution, but is unlikely to consist substantially in prosecution because that is so-time consuming. Active regulation is hence dependent upon the use of the agency's administrative powers. As indicated above, the coercive strategy is not commonly used, and is probably vulnerable to erosion and transformation into the persuasive, unless there are significant external pressures to sustain it. Constant contact with regulatees will in due course be likely to elicit some sympathy by inspectors for the circumstances of regulatees, which can lead to infractions and formal non-compliance at times, despite their best efforts. To continue sanctioning every infraction is not likely to elicit more than grudging cooperation, and regulation that is antagonistic is slow and difficult. Kelman (1981) describes the OHSA and health and safety regime in America in the 1970s in plainly coercive terms – inspectors imposed fines even if the infraction was corrected in their presence. This 'citation mentality' became subject to considerable pressure to change with the advent of the Reagan administration as sentiment moved against rigorous enforcement. Similarly, Shover *et al.*'s (1982) study of open-cast mining found some regions in the same period that applied the rules stringently, with automatic penalties for infractions. By the 1990s reliance on the persuasive strategy had become so widespread that Rock could claim that it 'probably deserves to be taken as the major pattern or archetype of formal social control in western society' (cited in Hutter 1997, p. 242).

The persuasive strategy, because its approach is mild, needs to be able to shift to a tougher stance if needed in order to achieve results. If we conceptualise the bottom of this hierarchy as monitored self-regulation, that is, the regulatees achieving substantial compliance on their own initiative, with inspection and reporting to oversee it, the opposite end of the hierarchy involves command regulation, with formal requirements to comply in specific terms by a given date or face penalties. It is the styles in between that are of more interest, since it is there that most regulation takes place. Clearly persuasion is part of this, but as Hutter (1989) points out, persuasion can be more or less tough-minded. She distinguishes persuasion, which involves repeated contact, discussion, advice and provision of information, from insistence.

> The insistent strategy is less benevolent and less flexible than the persuasive approach. There are fairly clearly defined limits to the tolerance of officials adhering to this strategy. They are not prepared to spend a long time patiently cajoling offenders into compliance and they expect a fairly prompt response to their requests. When this is not forthcoming, these officials will automatically increase the pressure to comply. They will readily initiate legal action to effect their objectives should they encounter overt resistance to their requests. However, it is important to stress that the ultimate objective of these enforcement moves is to gain compliance, not effect retribution….

> The insistent strategy differs from the sanctioning (coercive MC) model of enforcement both with regard to its objectives and methods…whilst [environmental health] departments approximating the insistent strategy would more readily serve legal notices than those following the persuasive strategy, their actions in the case of non-compliance are similar. In all departments non-compliance with a notice was likely to lead to the initiation of court proceedings. Likewise they would all adopt the common practice of terminating these proceedings if the offender remedied the problem before the hearing (p. 156).

We can thus put the enforcement hierarchy as follows:

Tactics to achieve compliance	*Instruments to implement the tactic*
Command	Formal requirement
Insistence	Request
Persuasion	Advice
Monitored self-regulation	Information

Hutter uses the term ‘strategy’ in respect of insistence and persuasion because life is not quite as simple as this. While the effectiveness of the persuasive strategy in achieving compliance is reliant on the availability of a hierarchy of increasingly tough tactics backed by a hierarchy of sanctions, as outlined in the previous chapter, there are also variations in the propensity of different agencies, and of different officers within agencies to use these various tactics. Thus insistence may be relied on as a general strategy by some officers, where others rely on persuasion and are reluctant to adopt an insistent style. The reasons for this are varied. If a regulatee or a type of regulatee, or even an entire industry is perceived as recalcitrant or truculent, a firm, insistent style may be used from the start, which may change to a more relaxed, persuasive style if improvement in cooperation is shown. Individual officers may have personal preferences for one kind of approach rather than another, and officers may develop cultures which favour a particular style. This in turn may reflect the pressures that inspectors work under. Thus Hutter (1989) noted that environmental health departments with more resources tended to use the persuasive style: they were not faced with very serious health problems, most regulatees had quite good standards and their jurisdictions were smaller. They had time to spend with their regulatees, where those officers in areas with more problems and lower average standards had more problematic regulatees to deal with, and tended to be more brusque in consequence. Similarly the

Factory Inspectorate used the insistent style, where the Industrial Air Pollution Inspectorate used the persuasive. The former had one field inspector to 747 regulated premises where the latter had one to 68 (1989, p. 164).

Hutter also maintains that the political environment affects compliance tactics. The use of insistence in urban areas reflects the fact that in areas 'which have a high concentration of rented accommodation and a close proximity of industry and housing, environmental health problems are likely to be immediately visible' (1989, p. 166). In addition, environmental health departments' decisions to prosecute were subject to review by the local councils which maintained them. Councils varied in their concern to review departments' recommendations, and in their readiness to accept or reject proposed prosecutions. In one case, officers were left in no doubt of the opposition of the council to prosecution, and it had the lowest rate of prosecutions of the four cases studied.

The approach adopted by inspectors also reflects their view of the regulatee and the nature of the offence. Thus some regulatees may be seen as generally non-compliant – scrap-metal dealers, for example – yet at the same time a scrap-metal dealer was cited as a showpiece site because of high levels of cooperation and the maintenance of high standards (Hawkins and Hutter 1993, p. 205). Conversely, water pollution traced to a 'good' firm with a compliant record 'will almost certainly be framed as an accident, and may not even be described as pollution' (ibid., p. 205). Instant compliance may be required by inspectors where remedy is both essential and easy, for example in securing a ladder on a building site, or replacing a guard on a machine. Willingness to impose sanctions reflects not only the toughness of the inspector, for whatever reason, but also the ease with which sanctions can be processed and the significance and clarity of the infraction and the risk it creates. As Hawkins points out, prosecutions by the Nuclear Installations Inspectorate are very low because of the great licensing powers the inspectorate has (1989, p. 376). By contrast, cable-burners attract immediate sanctions because they tend to be itinerant, and hence are not known by the inspectors, and are in clear breach of the law. When the law is resorted to, inspectors not surprisingly use those parts of it that produce the quickest and most reliable results. 'You go for Section 14 of the Factories Act', said a principal inspector in a general manufacturing group, 'because it's absolute and there are hundreds of decided cases. You can't lose.' There were convictions in 97.8 per cent of cases brought under Section 14 in 1985. The imposition of an absolute duty, as the law has been interpreted to require, makes such cases easy and quick to prepare, and comprehensible for lawyers and firms: there is simply little room for argument (Hawkins 1989, p. 382).

Finally Hawkins notes a 'marked preference among Factory Inspectors for the prosecution of safety rather than health problems' (ibid., p. 384). Not only do safety matters involve dramatic incidents and accidents, where compliance failings are plainly evident, whereas health issues involve longer-term risks but the risks in health cases are frequently contestable. 'Preparing the case to meet the standards of evidence required in an occupational health case will inevitably involve expert medical evidence and can be extremely time consuming, serving to deter inspectors from prosecuting' (ibid., p. 385). We can generalise this point from health and safety to say that clear violations, involving obvious and substantial damage, are much easier to sanction than violations which are deemed hazardous because they involve the possibility or even probability of damage. Just such difficulties surrounded the establishment of accepted standards of sales practice in the retail financial sector in Britain (Clarke 1998a). Because of the medium- and long-term nature of investments and the volatility of markets, it is hard to show that one product is better than another and, because of differences in the nature of risks involved, sometimes even hard to show that one kind of product performs less well than another. It was hence hard to prove that sales advice should follow a prescribed pattern and difficult to resist the desire of sellers of any given type of product or product range to want to proclaim their virtues at the expense of admitting their weaknesses.

While there clearly are differences in the way in which regulators go about seeking to achieve compliance, the reasons for these differences are very diverse and dynamic. Although individuals, officers and agencies may come to prefer one style or approach, it is unlikely that a rigid preference will always yield results, and a willingness to adapt to changing conditions and to the changing demeanour of regulatees is essential to success. We should hence recognise that there are pressures towards the use of a limited range of tactics as a single style, but that these are unlikely to be appropriate in all cases and over extended periods, and can result in stereotyping which can be counter-productive. The construction industry provides a good example of pressures which lead inspectors to adopt an insistent style and a willingness to resort to formal sanctions quickly. As Hawkins puts it:

> Building is an ephemeral activity moving in a series of phases – excavation, construction, roofing and so on – with methods of work

> generally regarded as inherently dangerous, and with constantly changing risks, which often involve different kinds of work people. The lack of stable and co-ordinated social organisation leads to mistakes, and mistakes lead to accidents. As a result it is generally accepted in the Factories Inspectorate that the numbers and kind of risks routinely encountered by construction workers are larger and more serious so far as the individual worker is concerned than in other types of industry. ... [T]here is at present considerable competition in the construction industry in Britain, and many firms are under extreme pressure to keep costs at a bare minimum.... In such circumstances safety precautions are often the first to be dispensed with. Many construction firms are accordingly regarded by Factory Inspectors as having a substantial incentive to save on safety.... Allied with this is a general view of management in construction as ill-informed about safety matters, as often disorganised and sometimes disreputable.... So far as the regulatory inspection is concerned.... transience means that decisions about what action to take have to be made on the spur of the moment, since the chances of a quick return to the site for a follow up visit to monitor progress... are very remote.... This may encourage a tendency to err on the side of severity in approach to enforcement (1989, p. 374).

The pressures, all in the same direction, are evident enough, but there is another side to the picture. Construction will not lose all its characteristics overnight, but some projects are long-term, and much construction work is undertaken by large firms. True, there is a great deal of subcontracting, which contributes to competition and disorganisation, but this is not an essential feature of construction, only the way it operates in Britain at present. Further, construction has shown a significant tendency to move from a craft-based to an industrial-based set of technologies over the past two or three decades, with more and more work being undertaken off-site and being assembled on-site in prefabricated sections, using larger and more sophisticated machinery and far fewer employees. Nothing can eliminate the problem of all sites being new and unique, and of construction being a process of change, but the management of sites today is a far more industrialised and well-understood procedure and less the application of large numbers of skilled craftsmen and unskilled muscle power.

Generalisations as to how compliance is best achieved are hence difficult to find and justify. The variety of factors affecting what is most effective has only been touched upon here and is very substantial.

While it is possible to suggest plausible generalisations, for example that effective efforts at obtaining compliance will depend upon adequate funding, staffing, training and motivation of regulatory staff and that clarity of objectives is also desirable (see e.g. Clarke 1994b), the richness of the context within which regulation is conducted, and the sophistication of many regulators as to how to go about their work in changing circumstances, with regulatees of diverse kinds and with an awareness of the political context, mean that many factors are operating at the same time. The fact that a particular individual or office uses a particular technique or series of techniques at a given time does not necessarily reflect a powerful culture – 'this is the way we do it here' – though it may. More likely it reflects a judgement that, given all the circumstances, this is probably the best bet. If it is not seen to be working, it then becomes critical both to ensure that the regulatee does not believe that the inspector will give up, and for the inspector to try different tactics. Judicious flexibility and persistence would thus seem to be fundamental to achieving compliance, backed by a willingness to use sanctions. As we saw above with construction sites, this may not in practice involve the inspector being able to make repeat visits. Flexibility may be constrained and this may lead to a tougher, insistent style, but that does not mean that all regulatees are to be treated as cowboys, or even as devious. There may be circumstances in which a subcontractor under pressure to finish his work to allow the next phase to go ahead would welcome the support of the inspector – if, say, the steel-fixers have not finished the reinforcement work or the shuttering is still incomplete, and the ready-mixed concrete lorries are beginning to queue up to discharge their loads. A rushed job can result in the reinforcing being misaligned and the concrete structure turning out below strength and liable to premature deterioration. Such situations call for judgement based on experience to get the best results – in this case reasonable compliance without a blazing row with the site agent over losing half a day while the work is completed and there is the risk that several loads of concrete will go off, and hence the risk of future antagonism.

These sorts of points were implicit in the only attempt at a systematic review of all the state regulatory agencies of one country, Grabosky and Braithwaite's work on Australia (Braithwaite, Walker and Grabosky 1987; Grabosky and Braithwaite 1986). They obtained cooperation in 96 out of 101 agencies and categorised them into seven groups in terms of their enforcement style. A number of points arise at a variety of levels. The groups were ranged on a continuum between those who enforced least and those who enforced most, and like other writers, the authors are clear that the coercive and persuasive strategies are the main underlying theme, and that nearly all the agencies lie towards the persuasive end of this continuum. What is of interest are the various tactics used as part of the persuasive strategy and the reasons for them. Thus, the group that enforces least does not prosecute at all because it does not have the powers. Instead it adopts the tactic of conciliation, bringing the parties together in an attempt to resolve differences. This group of conciliators, not surprisingly, includes four anti-discrimination agencies: the tactic reflects the task the agencies have. It also includes a prices-surveillance agency and four out of eight consumer-affairs regulators. As the authors note, this reflects another feature of conciliators.

> All of the conciliators are agencies established since 1970. Occupational safety and health regulation in Australia is being reshaped at the moment by taking on board important elements in the conciliation model. Tripartite structures, in which business, workers and government are represented are being set up at all levels of occupation health and safety regulation, such that the inspector is becoming more a facilitator of workers acquiring involvement in their own safety, by electing safety representatives and establishing safety committees to conciliate safety disputes. The intention in most states is that inspectors will spend less of their time reminding employees of the requirements of the rulebook, and more time explaining to workers how they can monitor the safety of their workplace and establish structures to ensure that grievances uncovered by this monitoring process are addressed. Similarly, commercial tribunals and audit tribunals are being established by most consumer agencies with tripartite representation of business, government and consumer groups as a means for conciliation rather than litigation of a wide variety of consumer grievances. (1987, p. 344)

The tactic of conciliation is hence a new and expanding one, achieved by involving stakeholders, almost as a substitute for agency sanctioning, and reflects a historic shift in the predominant style of regulation in Australia, on which see again below. But it is not appropriate to all areas of regulation. The next group in order of use of sanctions are the 17 benign big guns, which have very great powers of licensing, such as the reserve bank, the broadcasting tribunal, and the radiation safety inspectorate. These powers reflect the seriousness of the hazards regulated and command the respect of the regulatees, who are mostly large and few in number, and socially close to the regulator, whose influence, both formal and informal, is hence great. Lack of sanctioning reflects the regulators' success in achieving compliance and a lack of catastrophes.

Not dissimilar are the 11 diagnostic agencies. The difference from the benign big guns lies in part in their willingness to prosecute on occasions, and to target individuals, not firms, when they do, but more in their emphasis on decentralised inspection by highly qualified staff, giving advice to regulatees and encouraging self-regulation. This group includes mines and radiation-safety inspectorates and the national biological standards laboratory. Once again the style is the one appropriate to the task.

The next two groups, nine detached token enforcers and seven detached modest enforcers, are the least coherent. They are distinguished by the greater willingness of the latter to prosecute, and as a pair by their arm's-length relationship to regulatees. They form a contrast with the largest group of 25 token enforcers, who are more proactive, are rulebook-based and prosecute regularly, but with very low penalties. It is this ritualistic style of regulation that has been characteristic of Australia, argue the authors.

> This predominant style is a long way from both the ideal of an adversarial enforcement agency which forcefully pursues a policy of deterrence, and a long way from the ideal of an agency which helps industry to diagnose problems, which persuades and educates. Far from either deterring or diagnosing, these are agencies characterised by perfunctory rulebook inspections .... Their standard practice is to go into workplaces, tap management on the shoulder, and remind them of their legal obligations when non-compliance with the rulebooks is noticed. When they engage in enforcement it is also perfunctory. If the tap on the shoulder fails, the agency will either forget about the problem, or launch a prosecution, which will generate a fine averaging $200 for most agencies. These are minimal penalties because civil remedies are not generally available to Australian regulators. (p. 339)

Not that these agencies are captured by their regulatees – they do not merit the effort to capture them. The contrast with Hutter's 'insistent style' is obvious: Australian regulation could obviously do with rather more insistence and bluffing to back up weak enforcement powers.

The final group are the 18 modest enforcers, who are the closest to the coercive strategy, and who are willing to use all the sanctioning powers available to them: civil, criminal, administrative and publicity. They do not form a coherent group in terms of remit and include, besides agencies having responsibility for corporate affairs, food, environment, harbours and weights and measures inspectorates for some states, where the same inspectorates in other states fall into different groups. Perhaps the main point about this group is hence that, for unexplained reasons, they take their task seriously and are determined to obtain results, which they do by using their enforcement powers more fully.

Like other work, then, Grabosky and Braithwaite's review provides insights into how compliance can be attained, including a reminder that agencies may set their standards very low. Despite the best efforts of the authors, however, the variety of factors in play frustrates a definitive outcome. We are still a long way from formally identifying and evaluating the interaction of all the relevant factors and hence constructing a model of compliance-achievement, though we are arguably approaching the point at which the largely qualitative research, which has sensitised us to the complexity and diversity of factors involved, could give way to a degree of formalism and attempts to identify the elements of a model. Hypothesis formulation and testing so far is confined to identifying factors that can be shown to be empirically significant, rather than showing how they interact with a range of other factors, an admittedly much more demanding task.

It can be suggested analytically that such a model would need to take account of inputs from three directions: from the agency itself, its staffing, funding, powers and responsibilities for track record; from the regulatees, their size, numbers, powers, nature of regulated activities and their stances to the regulator; and from the regulatory context, both political – the profile of the agency and its regulatees, the nature and extent of the political support for regulation; and institutional – the degree of overlap with other agencies, resulting in restraints and opportunities, for example. The outcome of the interaction of these three sources will be the adoption of a regulatory strategy and tactics, both situational and predominant, as a result of which the regulator will attempt to achieve and sustain a culture of compliance, that is, a relatively stable institutionalised pattern of interaction as a result of which the agency feels reasonably sure the compliance-levels are well up to essential levels, and hopefully in many cases beyond. This, of course, will not be a stable state, but only achieved by sustained effort in the first place, and kept in place by flexible deployment of sustained skill and effort. It will involve the acceptance by regulatees that compliance is a part of their life, whether voluntarily or grudgingly. A sustained culture of compliance is hence likely to lead to an ascendant regulator but this need not necessarily be the case. Ascendancy presumes that the purposes of the regulation are clear and attainable, and that regulation is constantly developed and is seen to be developed to pursue them.

Compliance raises the question: compliance with what? If the demands of the regulator are minimal, compliance may exist but be valueless. If the demands are inappropriate to the objectives, compliance may yield few benefits. If the demands of the regulator are unattainable even with the best efforts of the regulatees, compliance can only be apparent not real, and is likely to be underlaid with cynicism where there is not outright antagonism.

A weakness of much of the literature is that it takes compliance not only as a self-evident goal, but as an end in itself. Compliance is only a means to achieving regulatory goals. It is up to the regulator and its political masters to ensure that those goals are properly identified, and that the detailed demands of compliance, practical regulation, are developed appropriately, realistically and relevantly to achieve them. In the case of much environmental regulation, for example, this has been done: rivers are cleaner, air pollution from traditional sources is less, standards are more wide-ranging and complex. The difficulty is that there is an ever-widening variety of pollutants: car exhausts rather than coal smoke, oestrogen-mimicking chemicals rather than arsenic. In other cases, notably the financial sector, regulation has proved much more problematic, so raising questions not only about compliance, but about what compliant regulation can achieve: effectiveness.

6
Ineffective Regulation

The thrust of this book so far, and of the previous two chapters in particular, has been about how regulation works. Braithwaite's negative evaluation of the predominant style of regulation in Australia – 'going though the motions' – is a sharp reminder that regulation may not work. An extreme example of the ritualistic Australian style is provided by the asbestos mine studied by Gunningham (1987) and discussed in Chapter 4. The reasons for ineffectiveness, like the means used to achieve compliance, are very varied. We should be in no doubt, however, that success in achieving compliance or even ascendancy does not necessarily result in effectiveness, though in the latter case this is certainly a likely result. If the requirements of compliance are set at very modest levels they may easily be achieved, but regulatees will still be able to do more or less as they please. If the regulator is ascendant it will be able to influence regulatees substantially, not least because they accept regulatory objectives. Questions still arise, however, over whether those objectives are realistic. As Yeager (1995) points out, the 1972 Clean Water Act in the US explicitly required the elimination of all industrial water-pollution by 1985 (p. 257). Implementation was to be achieved by the Environmental Protection Agency, which was large and had substantial powers and public support. Despite this it is a moot point whether it ever achieved ascendancy over industries which perceived it as oppressive and unreasonable and which resisted it strongly.

Evidently, however, ineffectiveness does not only result from capture by the regulatees, as much of the earlier literature implicitly assumed. That is one source, but only one, and there are many other ways in which worthwhile and well-intentioned regulation, that is regulation which addresses issues that would benefit from intervention, can go seriously wrong and become counter-productive (Grabosky 1995) or even criminogenic (Clarke 1994a). We shall look at some examples of this in this chapter. Most involve substantial failures which invite at times incredulity at the naivety of politicians and regulators. Sometimes there is an explanation in terms of ideology and complacency, but we should beware of the privilege that hindsight gives us. Regulation is often initiated in reaction either to a new initiative – setting up a new stock exchange – or to a serious perceived failing – rising levels of environmental pollution. There will of course be those who will attack a regulatory initiative because they fear that it will unduly restrain them as likely regulatees. There will be others generally sceptical of the benefits of regulation who will act as Jeremiahs both at a general level and in pointing at the potential problems of any proposed scheme. The danger is that this political and often ideological conflict polarises debate and prevents careful review of the risks that setting up regulation in a particular way will be ineffective or counter-productive. In other cases, as we shall see, there may simply be a lack of attention to these risks despite general agreement on the regulation.

Since regulation is initiated and sustained by politicians it might be thought that remedy is similarly achievable by political review. This is true only if the regulation is seen to be ineffective and if as a result it rises high enough up the political agenda to merit a serious input of time and effort by governments. By that time a great deal of damage may have been done, not least to public confidence in regulation, and to relations between regulators and regulatees. While regulatory agencies may develop by making minor adjustments, which at times may need legislative approval, substantial review tends to be the result of substantial failure. Even then, politicians may be unwilling or unable to contemplate a serious review as our first two examples indicate.

The USSR

The former Soviet Union stands as the greatest example of regulatory failure in history. The intentions of politicians were at least partly benign: to ensure that all were provided for in every respect. Part of the reason for the collapse of the USSR is to be found in the self-seeking apparatchiks who sought wealth, power and privilege and took advantage of an authoritarian and bureaucratic system to achieve this, so alienating many in the general population and making a nonsense of communist ideology. It is not so certain that the system would have failed if problems had been confined to the greed and arrogance of the political elite, however. Disintegration and collapse was made certain by the progressive failure of the planned economy to achieve benefits for most of the population. Central planning, with its control of most resources, human and material, could achieve a great deal in specific projects – military weapons and space technology, for example. Gosplan, the central planning aparatus, was simply too big, cumbersome and inefficient to supersede and coordinate all the billions of judgements and decisions made annually on an autonomous basis in a capitalist economy. Coupled with constant pressures upon production units to achieve targets that were often unrealistic in any case, the result was progressive failure. Remedy lay in what formally was corruption, but which inevitably had to be tolerated even though it fed into other forms of self-seeking and personal enrichment.

Thus a factory manager would be given a quota by the plan for the production of, say, electric motors. He would also be expected to employ and pay a workforce of a given size and to maintain and renew his plant and machinery. Yet he would find it difficult to ensure the commitment of his workforce, because wages and official rewards were limited, because it was almost impossible to obtain new machinery to replace that which wore out, and because there were constant problems with the supply of raw materials. While one solution was to fudge output figures (Shenfield 1993), more practical steps had to be taken to achieve output. Party and plan officials needed to be placated or, even better, induced to use their influence to obtain supplies. Workers needed to be motivated and rewarded. It might hence pay to divert part of the workforce to producing something quite different – say, electric irons, which were in chronically short supply. One would then have the wherewithal to barter batches of irons for copper for the electric motors and also use gifts of irons to local officials to keep them sweet. The rest could be sold to retail outlets at a good profit to provide funds for paying the workforce. The shortages of goods in shops led to various alternative means of managing the market.

> For example a saleswoman tells her friends when a scarce commodity will be arriving. The purchasers arrive, stand in a queue and buy the commodity; or the salespeople put it aside.... The amount of the additional payment in such cases is lower than that charged by speculators, but it is more difficult to find salespeople who are ready to take a risk with people they do not know....
>
> The overwhelming majority of salespeople in shops selling manufactured commodities participate in selling off scarce commodities in

> this way because scarce commodities appear in practically all the shops. Even if a young salesgirl is honest, she is forced to engage in this activity by the departmental head, to whom she must kickback part of the income. He in turn must give a kickback to the shop director who in turn gives one to the area trade office, or to the wholesale base from which he received the false commodities (after all they could have given them to someone else). So it goes on until one reaches the very pinnacle of the trade hierarchy. Trade malpractices revealed in the late 1950s indicated a person involved in this process included the USSR's Deputy Minister of Trade.
>
> (Katsenelenboigen 1993, p. 230).

The consequences of these constant failings in the planning system could be very debilitating at the plant level as well. The sadness and desperation of the sanatorium director in the following quotation is evident.

> The sanatorium where I worked was a separate settlement. There are buildings for patients, houses for staff. In these buildings the water, electricity and sewage systems must work … and be maintained. Families grow and you need more houses, you need to expand the sanatorium. So you always need building materials, you need contractors who are going to build this, you need to know how to obtain money to pay for it and money … is mainly non-cash, everything is signed for through the bank. This also creates difficulties, because the bank doesn't always want to pay. It is very difficult to do all this in legal ways. It is difficult to get yourself put into the plan and get a contractor who will build this, it is very difficult to get hold of the necessary funded building materials, even if there is the money for them and you order them year after year. You don't get them. All this you literally have to get hold of and to get hold of it you must ask, and demand, and humble yourself to get it by hook or by crook …. I look for a contractor and I've been assigned money for this …. But the contractor's plan is already full … they say they cannot take me …. They haven't got the materials. That means that I must obtain the materials for them as well. And to overcome the complications, spirit (pure ethyl alcohol) has a great significance. If I had a cistern of spirit I could build a whole sanatorium next door to mine for the cost of several million roubles … pure spirit is better than vodka …. The money that I was allocated for this construction is money only on paper …. If (the builders) are going to take on

> extra work over and above their plan one must reward them in some way. But since they know that I am the head doctor, that I have spirit, they demand it.
>
> (Lampert 1985, p. 25)

In the Soviet Union the regulation of everything in the economy hence resulted in severe dislocation, which had to be compensated for *ad hoc* and created not merely a black market, but a range of parallel markets identified by different colours (grey, brown) by commentators (Katz and Katsenelenboigen 1977; Grossman 1978; Feldbrugge 1984). Politicians were fearful of dismantling regulation because it could involve some loss of control, and in any case too many power-holders had used the system to benefit personally. Besides, there was the problem of ideology, the problem of recognising that comprehensive economic planning had failed, with the risk that this would be taken as an admission of the failure of communism, a problem that is currently being addressed by China.

The disintegration of the USSR as a result of the failure of the planned economy led to the end of the Cold War and a good deal of triumphalism in the west.

The limitations of the views and efforts of the new right in respect of regulation have been commented on at various points already (notably Chapters 1 and 2). While ideology plays an inevitable role in regulation, it has been argued earlier that this does not entail the possibility of a realistic continuum in which everything is regulated at one pole and nothing at the other. Rather a degree of regulation is a feature of industrialised democracies. Governments committed to ideologies of most if not all positions are hence capable of regulating aspects of the economy and of getting it seriously wrong, as the next two examples illustrate.

EU agricultural subsidies

The first example is the European Union, that modern epitome of the social market economy. The six founders of what was then the European Economic Community created by the Treaty of Rome in 1960 took as one of their leading objectives the management of Europe's food supply. That had a number of sources. The aftermath of the Second World War, with its massive devastation especially in continental Europe, its millions of displaced people, many of whom came close to starvation in the latter 1940s, was only a decade past. Agriculture, even in its modern mechanised form, is still subject to considerable volatility. Adverse weather and disease can dramatically affect crop yields and animal husbandry – foot and mouth disease, tuberculosis, bruccelosis, swine fever and other infections posed considerable problems. World food prices were even more prone to volatility as crop failures in major countries (notably the USSR) could lead to significant increases in demand, and surpluses to dramatic price falls. Further, continental European agriculture was not by any means modernised. There were very large numbers of small farmers with limited mechanisation and they voted in large numbers for the Christian Democrat and Gaullist parties which dominated government in the three dominant countries, Italy, (West) Germany and France.

The aspiration was to achieve agricultural self-sufficiency while encouraging exports. Little pressure was to be exerted on farms to consolidate, but modernisation was encouraged. Security in respect of food supply would hence be obtained by providing security for farmers, who would be encouraged to invest and modernise as well as hopefully voting in the right way. The machinery devised and constantly elaborated to achieve this was a system of tariffs, subsidies and price guarantees that applied to all sectors of agriculture. Imports were generally to be restricted, exports to be supported and producers paid guaranteed prices. Buffer stocks were built up to ensure supply in case of shortage and to store surpluses until they could be off-loaded on to the market.

There seems to have been little historical perspective in the construction of this regulatory system. The objective was stability and security of supply for the population and income for the farmers, and that was a permanent goal. The question of whether the system as it was established could remain appropriate to achieving this goal as time went on seems not to have been asked, not least because there were evident political and economic pay-offs. These continued as the EC expanded from six to 12 and then to 15. The advent of countries with large agricultural sectors and lower levels of industrialisation in the second wave (Spain, Portugal, Greece and Ireland) greatly expanded the European Common Agricultural Policy, and the subsidy funds in particular, which amounted to more than 60 per cent of EC funds as the total reached £25 billion by 1987. This is a considerable sum to be spent annually on claims for subsidies, price guarantees, tax refunds and the like, and its administration involved a number of serious weaknesses.

Most fundamentally the scheme is administered by the civil service of the EC (now the European Union), the Commission, but actual implementation is largely at local level by member states, who are effectively responsible for validating claims for funds. Since the funds are EU money not national money, it is only too easy for them to be perceived as money to be grabbed rather than as a cake to be shared out equitably. Further, if false claims for funds are uncovered the member state is debited that amount and is expected to recover the money, an arrangement which obviously favours lack of serious investigation of claims. The EU has only limited powers of inspection and investigation in member states even in respect of EU funds, though these powers have been extended recently, a feature which reflects the fact that the 'Union' is an economic but not a political one. There is hence a degree of increasingly formalised cooperation in policing matters, but no European police force. Further, the Commission is not genuinely accountable to the directly elected European Parliament, whose only sanction is to refuse to approve a budget. Rather, it is accountable to the Council of Ministers, which is nominated by the member states' governments. There is hence no European government which arises out of the European Parliament, and negotiations in the Council of Ministers reflect the interests of individual member states rather than a party of government. Because there were more agriculturally biased members of the community of 12 than there were industrially-biased, opinion in the Council naturally favoured the expansion of the agricultural funding subsidies, which fell heavily on the industrialised members, particularly Britain with its modern agricultural sector and relatively small number of farmers. This so incensed Mrs Thatcher that she demanded a refund, and Britain continues to receive £2 billion annually in recognition of its unusual position.

In sum, the agricultural support system amounted to a proliferating series of schemes designed to pay out money in various forms of subsidy and support, but with considerable structural weaknesses in respect of ensuring that individual payments were justified. The outcome was a rising level of abuse, documented annually by the Court of Auditors, which was established as an independent body in 1977 to oversee expenditure. Despite the court's consequent complaints (EC/EU *Official Journal*, annually) and attempts by some members of the European Parliament to get the matter taken seriously, the subject became more a matter for academic investigation than political remedy, with a leading expert estimating by the latter 1980s that at least 10 per cent of funds were being wrongly paid out (cited in Clarke 1993). It was difficult for Ministers in the Council to point the finger at each other and none were willing to countenance the loss of sovereignty entailed by creating an EU inspectorate with adequate staff and powers to address abuse.

It was hence left to the Commission and the Court of Auditors to attempt to document specific abuses, especially where these were established over a period of years, and to put pressure on member states to introduce remedies. This had the effect of limited and local success on occasions and of gradually pushing EC fraud and abuse up the political agenda and giving it more publicity, but not of overcoming the structural obstacles to reform.

At a more immediate level, however, there were also a variety of factors conducive to abuse. The various schemes for the different sectors of agriculture – meat, dairy produce, wine, olive oil, cereals, etc. – are complex and change regularly. By the latter 1980s there were 1200 categories of agricultural produce, including nearly 400 for milk and 80 for beef, with the world divided into 11 zones for beef exports. There were hence 880 possible rates of beef subsidy, for example, ranging from nothing to nearly 100 per cent. This complexity inevitably produced a vast administrative load which often made adequate verification impossible, with the result that the Court of Auditors investigations found that:

> Paying agencies in the member states had accepted as primary proof of arrival at final destination, and without further enquiry, documents purporting to be the customs entries or annexed documents without customs signatures or stamps; secondary proofs of dubious authenticity, for example (1) certification of importation to Libya with the letter heading 'Foreign Office Bucharest'; (2) certificates of importation dated prior to the arrival of the goods concerned; (3) certificates provided by a commercial superintendent's company with apparently no presence in the country concerned, nor expertise in the commodity traded, and sometimes long after the arrival of the goods concerned; (4) bank certificates showing that the invoices for the goods had been settled, but which gave no evidence of the source of funds.
>
> (Court of Auditors Report 1987, 3.26, in Clarke 1993)

Nor was physical identification of produce any better. The Court of Auditors found that record-keeping at cereal-storage facilities was rarely reliable and almost never independent of the owners and storers, and that quality controls on stocks were quite inadequate during and after discharge. Substantial errors were shown in the amount said to be in storage and discharged month by month. Since monthly statements by member states are the basis for claiming subvention funds, this seemed to indicate a general awareness that member states could only gain from running a lax monitoring regime.

The same limitations on defective monitoring affected wine, which has been subject to chronic over-production in the EU as a whole, resulting in a vast 'wine lake' of intervention stocks. As a way of controlling this it was decided to distil some of the stocks into alcohol, which could then be used for other purposes. If the wine was to be distilled rather than drunk, however, palatability became irrelevant and growers began to stretch their capacities to the limits to produce more, reprocessing grapes and adding various artificial ingredients. As a result the amount of wine distilled grew from 4 per cent of the sector in 1976–7 to 29 per cent in 1983–4 before being limited to 18 per cent in 1987 in the wake of a series of enquiries by national governments and by the Commission.

Olive oil was a source of similar difficulties. Because olives are often grown in small groves on hillsides and one small proprietor may own a patchwork of trees scattered over a wide area, it is very difficult to verify production and exaggerated claims, especially in Italy, began to present a substantial problem. In the end the prospect arose of the Commission using its ultimate power to refuse to fund the entire sector because of inadequate monitoring and consequent abuse. The Italian government was finally moved to act, undertaking a detailed aerial survey of growing areas and establishing its own monitoring agency Agecontrol, with substantial powers. These it used to check the output of the oil mills by calculating electricity consumption and the amount of husk, and cross-checking with the producers' claims and the aerial survey. Mills shown to be exaggerating were derecognised and received no subsidies and claims for subsidy fell by 30 per cent in the first year of the new regime. As similar scheme was then extended to Greece and Spain (Clarke 1993).

Olive oil was hailed as a success story, but it shows only that some progress can be made if member states are sufficiently embarrassed. The commission lacks the resources to achieve this on a large enough scale to achieve reform, though progress can be made in administrative improvements, computerisation of records and simplification of some of the schemes and their rules. If support schemes as a whole are to continue, however, the incentives, if not to cheat at least to tolerate laxness have to be addressed, either by allowing a large and effective EU inspectorate with adequate powers, or by requiring member states to produce their own monitoring agencies for all sectors and schemes and improving their standards of training and staffing to EU norms. There are only limited signs of this happening.

The continued growth of fraud and publicity about it and the growing involvement of sophisticated criminal networks pushed the matter up the agenda sufficiently for the Council of Ministers to call for more action in 1993. The Commission proposed an anti-fraud strategy in 1994, including a stronger operational presence by its inspectors, made easier by the cooperation clauses in the Maastricht Treaty of European Union, attention to EU legislation and its potential for abuse, and improving the compatibility of legislation in member states. This initiative was less important in itself than for its effect in putting fraud permanently on the agenda and hence raising expectations that it would be reduced. Despite the increased staffing of the Commission's anti-fraud coordination unit and the setting up of its own database (White 1999), and the establishment of an advisory committee to learn the lessons of major cases, fraud increased in the ensuing years, with the smuggling of cigarettes and alcohol giving particular cause for concern. In 1995 the specific offence of fraud against community funds was agreed to be incorporated in all member states' legislation, and task forces attacking particular problems began to produce results. Losses continued to rise, however, and the limitations of EU powers were evident in the achievement of an agreement which established for the first time a legal basis for the establishment of a database fed with information from all member states (EU General Report 1994 1145, 1147; 1995 1008; 1997 1089).

Substantial change is likely from another direction. The enlargement of the EC by the admission of the southern European members put extra strain on the system and brought abuse on to the political agenda – just. Further enlargement to 15 involved prosperous northern industrialised nations – Finland, Sweden and Austria – which did not increase the pressure. However, the prospect of eastward expansion into the former Soviet bloc countries, with Poland and its large unmodernised agricultural sector in the first wave, markedly increases the pressure for reform. Sustained American pressure for the elimination of subsidies and tariff barriers by the EU in the Uruguay round of the General Agreement on Tariffs and Trade in the 1990s further increased pressure to reconsider the need for the provision of so comprehensive and detailed an agricultural support system. Radical reform will be painful, especially for the original members of the EU, but it seems increasingly likely.

In the two cases of ineffective regulation we have looked at so far, the weaknesses are political in origin, even though there may be room for serious attempts at technical improvement. Although the

Soviet Union collapsed in part because of the economic inadequacies of the planning system, the story was more complex than that and continues to unfold – it certainly has not been possible to substitute a free-market system for a planned one in any straightforward way. Like the EU Agricultural Guidance and Guarantee Fund, which administers subsidy and other payments, the failings of the USSR were for a very long time chronic rather than critical. The next two cases involved major crises: the forced closure of the Hong Kong Stock Exchange following the world stock market fall in October 1987, and the failure of large numbers of savings and loans institutions in the US at the end of the 1980s. Both were catastrophic failures of regulation and in both cases it is easy to see why, and that failure was directly related to the weakness of regulation. Whereas the difficulty of politicians in undertaking a serious structural review of regulation in Europe and the USSR is understandable, in Hong Kong and America it is more perplexing: why could they not see that they were riding for a fall? As we shall see, there are explanations, and they are a sobering reminder of the potential for regulation to be at times not merely weak but crass.

The Hong Kong stock and derivatives markets, 1987

The decision to close the Hong Kong Stock Exchange and the Futures Exchange for four working days – a considerable period given the closure of London for only a day after declaring war on Germany in 1939, for example – came in the wake of a 10 per cent fall in the Hong Kong Stock Exchange (HKSE) in one day, and in the light of probable further falls given news that US markets were continuing to drop. Yet Hong Kong was the only major exchange in the world to close: was this really necessary? (Gunningham 1990). Failure to close would certainly have led to a period of chaos, because the markets' control and safety mechanisms were incapable of coping with the stresses created by the fall. It was the weakness of those regulatory arrangements, coupled with the character of market participants, that led to disaster. Although these weaknesses were so substantial and pervasive that they would probably have produced serious problems elsewhere in time, it was not the main stock exchange that precipitated crisis, but the relatively new Stock Index Futures Market. Hong Kong's commodities futures market was relatively well established but small, whereas the financial futures market was introduced in mid-1986 and by September 1987 over 600 000 lots were being traded. This market essentially involves betting on the stock market index, the Hang Seng, with participants buying if they believe it will rise and selling if they think it will fall, with contracts priced at $50 a point. Contracts are settled in cash, avoiding the need for the formality of share certificates and the like.

Stock market futures markets have developed to allow substantial investors to hedge, that is, to offset a potential movement in the market. Thus, if an investor believes the market may fall he can take a position in the Index Futures Market to offset his potential losses, and so need not sell his stock, avoiding transaction costs. The difficulty is that sentiment in markets tends to be significant and hedgers all tend to feel the same way at the same time. The market hence needs speculators willing to take an opposite position to function properly. These participants are much closer to gamblers and are in the market to make quick money. In Hong Kong they had entered the market in droves as the Hang Seng continued to rise and were caught entirely unprepared when it fell. The immediate remedy to a fall in the value of contracts is for brokers to ask for more money from clients – a margin call. The investor pays only a small portion of the value of the contract when he buys it, so enabling him to lever up the amount he can invest substantially. If the investor does not respond to the margin call the broker can sell the contract and recover the money that way. The 1987 crash, however, was so big and so fast that brokers were unable to move fast enough, and in any case there were very few buyers. Hence 36 400 contracts worth US$1 billion were left outstanding when the markets were closed (Gunningham 1990, p. 15).

It was not, however, only a problem of the speed of the market fall. The rules required clients to deposit 7.5 per cent of the contract, but in the very rapidly expanding and competitive market this was widely ignored. 'In some cases no margin at all was required and post-dated cheques were accepted in lieu of margin.' (p. 66) Nor were there any checks on the suitability of clients in respect either of their financial standing, or of their understanding of the market and of the risks to which they exposed themselves. These widespread weaknesses did not become formally apparent because brokers were only required to cover their net positions, the difference between long (rising markets) and short (falling markets) contracts. The risks inherent in a market with large numbers of small, unsophisticated investors may not have been fully appreciated, especially as they were geared up in the Index Futures Market, but they were not new.

> Hong Kong has always been a highly speculative market. In the 1970s an estimated 80 per cent of investment came from local

> sources. About 25 per cent of the population were involved in market transactions, the large majority being ordinary office clerks, factory workers and amahs together with some professional speculators using bank funds. The mid 1980s saw the entry of significant numbers of institutional investors, but the market remained essentially speculative in nature, with institutions accounting for 15 per cent of market activity and individuals nearer 85 per cent. (p. 43)

In the London Stock Exchange these proportions were the reverse.

This implied that large numbers of investors would not be able to meet their margin calls, leaving brokers to cover them. This they should have been in a position to attempt, given the undertaking by the Futures Exchange of a thorough financial vetting of members. In practice the only requirements of clearing members was paid up capital of US$270 000 and half of that for general members. Large numbers of brokers hence stood to be bankrupted and the Exchange's reputation brought into considerable doubt. Even so, order should have been maintained by the Guarantee Fund run by the clearing house. This had the job of offering to meet all buy and sell contracts, backed by a substantial guarantee fund to cover imbalances between them in case of crisis. In the event, the fund only amounted to US$2 million. The rescue mounted by the government required over $\$\frac{1}{2}$ billion to shore up the guarantee fund. This was justified in terms of the reputation of Hong Kong as a financial centre, the knock-on effects on the stock exchange and the fear of public disorder, but the question must be asked: who benefited? Primarily it was the local brokers and members of the exchange.

The stock exchange committee which made the decision to close the markets was composed entirely of local brokers, many of them exposed to severe losses, as they were also futures brokers with local speculators as clients. The closure was clearly against the interests of the foreign brokers, who were not represented on the committee because they were heavily outnumbered in elections to it and were not allowed representation as a constituency. They stood to gain from the crash, because they were and represented largely hedgers already anticipating a market fall. Why was this blatant conflict of interest permitted, and why did not the state intervene to rectify it?

The answers take us into the peculiar political circumstances of Hong Kong. The colony attributed its extraordinary success as a commercial and financial centre, especially after 1945, to a *laissez-faire* policy. 'The government operates in the belief that unfettered capitalism attracts big money traders, manufacturers and speculators, and that what's good for business is good for Hong Kong. There are few costs in doing business in Hong Kong and less government interference with those activities than almost anywhere else in the world.' (Gunningham 1990, p. 13) The government was hence strongly disposed not to intervene on a routine oversight basis, and was more or less willing to tolerate constant abuses in the stock markets as the price of the system (pp. 24–5). Business must be left to work out its own problems as far as possible. Further, the Hong Kong Stock Exchange had been founded by the British and run on the traditional British self-regulatory club-like fashion that prevailed in London until 1986 (Clarke 1986). Relations between the British and Chinese in Hong Kong (and elsewhere) had been powerfully coloured by a sentiment of colonial superiority, and the British kept the exchange to themselves, stimulating the Chinese to start their own exchanges. Despite warnings by the (British) Commissioner for Securities and Commodities Trading on the need for effective intervention, little was done and the British and Chinese exchanges became rivals. Unification was finally imposed in the interests of rather more orderly trading in 1985, despite opposition. Unification only served to point up divisions between Chinese and foreign brokers, and the key questions raised were hence how control of the unified exchange was to be exercised. The local Chinese brokers prevailed, both in having a powerful Chinese businessman made chairman, and in establishing the one-member-one-vote electoral system which allowed them to dominate the committee.

Two other factors are important in this connection. First, Hong Kong was due to revert to Chinese sovereignty in 1997 and in the meantime there was a political ferment over the amount of electoral democracy the Hong Kong Chinese would be granted before the handover. Having governed through a British colonial caste for most of the century, the British government suddenly discovered democracy as the end of their control under the 1897 treaty approached. Chinese control of major institutions was hence the major issue in political life. Further, however, many Chinese were uncertain about what Chinese rule would bring and keen to make as much money as possible before getting out. Their commitment to Hong Kong hence became progressively attenuated. The result was, as one businessman put it: 'Ethics and morals rate very low as far as businessmen are concerned. If they can cheat, they will cheat. In Hong Kong we owe the society nothing. There is no identity. It is a colony. A transient place. You are here to make money.' (p. 30)

This situation is the complete reverse of that pertaining in London, the long-term imperial capital, stable and organised, where commitment to institutions and to country, class and culture were taken as part of life's foundations. Such a society might sustain an effective self-regulatory culture. Hong Kong could not. Further, Chinese culture, argues Gunningham, is much less willing to acknowledge obligations to outsiders.

> Chinese business ethics, like Chinese ethics generally, are primarily situational. Obligations are owed first to the immediate family and lesser obligations to close relatives, distant relatives and certain other people with whom ties or mutual obligations have been developed. Beyond this group relationships are distant, characterised by an absence of trust. Perceived obligations or restraints in dealings with outsiders are minimal. (p. 29)

Given that the outsiders in this instance were those who had dominated and exploited the Chinese for the better part of a century, such established cultural views no doubt needed little reinforcement. The consequence was a culture in Hong Kong where money counted for everything. In the words of a Chinese commentator: 'The obsession with material goods constitutes the most significant motive force in the people's working and even non working behaviour. Material values are the major criterion used to evaluate the worth of things and people' (Lau, cited in Gunningham, p. 29).

If ever a financial system needed firm and substantial state regulation it was Hong Kong, but this was a society which above all celebrated the virtues of *laissez-faire* and non-intervention. The surprising thing perhaps is that it survived to 1997 with so few crises. As the carefully managed Sydney Exchange commented (see also Chapter 2) Hong Kong was a blueprint of how not to do it.

Savings and loans

The same might also be said of the regulation and especially the legislation on Savings and Loans institutions, the American equivalent of British Building Societies. These were secured by legislation in the early 1930s following the Wall Street Crash of 1929 which created the Federal Home Loan Bank Board (FHLBB) to oversee federally (as opposed to state) chartered savings and loans and to ensure the availability of money for home mortgages, and the Federal Savings and Loan

Insurance Corporation (FSLIC), which insured deposits so as to encourage savings. The FHLBB regulates 12 Home Loan Banks which channel funds to the Savings and Loans institutions at preferential rates of interest, the front-line institutions being highly localised and restricted to domestic mortgages on properties within a 50-miles radius of their head office. The idea was that home ownership and personal savings would be encouraged and entirely protected by the state, but that institutions administering this sector, although private, should be prevented from becoming large financial institutions: small, specialised, privileged and secure was the strategy (Calavita and Pontell 1990).

It worked well until the mid-1970s and the oil crisis, which resulted in simultaneous recession and inflation – 'stagflation'. Inflation rose to double figures by the end of the decade, with most interest rates as high or higher, but the savings and loans were locked into fixed-rate mortgages at half that rate. Unlike British mortgages, where variable rates, altered without prior notification or consent of the borrower, have been the norm for domestic mortgages until the introduction, for reasons of competition, of limited-term fixed-rate mortgages recently, in America fixed rates have long been the norm. In addition, developments in mutual funds (unit trusts) creating money-market based funds enabled ordinary savers to participate in high interest rates more easily, and further stimulated the outflow of savings from savings and loans. The result was that the industry became effectively bankrupt, with 85 per cent of institutions losing money by 1980.

The solution proposed was to dismantle the restrictions on savings and loans and so allow them to compete with other financial institutions. An initial modest de-reregulatory move in 1980 lifted restrictions on savings rates, but this merely widened the gap between rates for savings and for loans. At the same time insurance protection was increased from \$40 000 to \$100 000 per account, a move that was undertaken with little debate in response to lobbying by the savings and loans institutions themselves (Pizzo *et al.* 1989). In consequence depositors could not lose, provided they limited themselves to \$100 000, per account and would hence be encouraged to put money into those accounts offering the highest rates of interest. Competition would rapidly require much higher rates of interest, and this could only be seriously contemplated if savings and loans could start earning much more, necessarily from ventures other than domestic mortgages.

Initially the result of the 1980 legislation was therefore a worsening of the crisis, until the Garn St Germain Depository Institutions Act of 1982 eliminated the remaining restraints on interest rates and enabled savings and loans to make consumer loans up to 30 per cent of their assets, to make commercial and corporate loans up to 40 per cent of their assets, and to provide 100 per cent financing on loans. In addition, in 1980 industry regulators ended restrictions on savings and loans accepting certificates of deposit, short-term money brokered by middle men in search of the highest interest rates.

These were packaged into units of \$100 000 to qualify for FSLIC protection. Then the industry was capable of attracting deposits at competitive rates and of engaging in more wide-ranging and higher-risk business that should earn higher returns. Deregulation continued, with regulators abolishing the requirement for savings and loans to have at least 400 shareholders and with none holding more than 25 per cent of the equity, by allowing individuals to run them. Savings and loans could also be established with illiquid assets such as property. By the early 1980s therefore, savings and loans had moved from being restrained to very limited and protected business to being able to engage in almost any venture, under the control of a single individual, but with depositors comprehensively protected by the federal government.

This absurdity was reinforced by Congress, which in 1982 committed the federal government to underwrite the FLSIC, and so reassure depositors, as it was becoming clear that the FSLIC's own funds were rapidly running out. It was an extreme example of moral hazard, the effect of regulation, notably insurance, reducing the motivation of market participants to take reasonably prudent steps to protect their money. This can be a problem in much regulation which is designed to protect: taking care in a way which previously was thought essential to avoid a risk – it could be getting your clothing entangled in moving machinery rather than parting with your money – becomes someone else's problem once regulation and responsibility for implementing is introduced. To stretch the notion a bit, motorway driving may be said to be so easy, safe and boring that it induces drivers to relax their concentration, where on an unimproved single carriageway the need to negotiate the hazards of every rise and bend require constant vigilance. In the case of motorways, the net benefit is in no doubt. In the case of savings and loans it plainly served to remove depositors' need for sceptical enquiry before entrusting those savings to institutions that might be engaging in reckless ventures.

This problem was exacerbated by another one, regulatory arbitrage. Chartered savings and loans were federally regulated by the FLHBB, where state-chartered ones were state-regulated. As deregulation took off, savings and loans began to compare the requirements of their local regulator with those of the federal one and to shift to the least demanding. California, for example, was quite strict, with the result that institutions switched to federal regulation, and the California agency saw its funding halved and its full-time examiners fall from 172 to 55 between 1978 and 1983 (Calavita and Pontell 1990, p. 314). In reaction, California in 1983 liberalised regulation radically, a pattern that was followed by other states.

The same problem arises in a number of other fields. Many American corporations are registered in Delaware, for example, because legislative requirements are more limited there than in other states. Similarly, it has been remarked that the European directive on money laundering, which requires financial institutions to make appropriate checks on account-holders to detect and prevent the laundering of illegal funds through them, depends upon all member states having the necessary staffing, funding and expertise to come up to standard. There were no provisions for inspection and enforcement centrally, and hence there is a likely attraction in routing deposits through less well endowed states, given that there is a presumption that all states will comply with the directive and implement it effectively. Other member states are then required to accept the bona fides of those in the state where the funds originate that they are clean (Clarke 1995b). The problem also arose in the Financial Services Act 1986 which provided only that the SIB could refuse to recognise self-regulatory bodies and did not have the power to compel regulatees to join a specific body. This proved a serious problem when regulation was shown to be inadequate. It was evident that some institutions were opting for the self-regulatory body that seemed likely to make the fewest demands upon them. In addition, when regulatory review attempted to reorganise the front-line bodies by amalgamation, along with increased stringency, many financial institutions refused to cooperate for some time (Clarke 1998a; Jebens 1997).

Regulatory arbitrage is also institutionalised in the pharmaceutical industry (Braithwaite 1984). America is the most lucrative market for new drugs, but also the hardest in which to obtain a licence. Since full information on the effects of a drug on humans only comes out over time and with extensive use, animal testing and limited clinical trials never produce enough information. Drug companies therefore market their products initially to countries where regulation is weakest, often in the third world and move progressively through better organised and richer countries, gathering information as they go. Braithwaite also produces evidence of the selling of sub-standard batches of product, and drugs refused approval in industrialised countries, to less well-regulated ones.

To return to savings and loans, the outcome of the various deregulatory measures was an unprecedented disaster. Institutions already weakened by the experience of adversity under restrictive legislation in the 1970s were taken over and ruthlessly exploited by brazen fraudsters in the 1980s. Their exploits are described in detail by Pizzo *et al.* (1989). The need for funds was accommodated by the highly volatile brokered deposits, which required both hefty fees to brokers and high interest rates. These could only be earned by high-risk ventures, which always had to succeed, since a major failure would deflate confidence. The whole affair became a frenzy of speculation, and a reputation for continued activity – doing big deals – became vital to staying afloat. Industry insiders and more critical investors knew of the parlous state of the industry, including the new level of risks that were being taken. They continued to invest because their deposits were federally insured, but it was vital that adverse information did not leak out, since this would precipitate proper investigation and closure. The need for success against the odds led to wilder and wilder risks being taken and to blatant illegality being ignored. The other necessity was to keep the regulators at bay.

One of the most widespread of these new risks were loans for comprehensive development, referred to acquisition, development and construction (ADC). Normally a bank would only lend on part of this process of property development and rely on the rest as a source of security, not least because the property market is prone to booms and slumps. The danger is – and was realised in the context of the savings and loans bonanza in the 1980s – that the availability of ready loan-finance drives property market prices, which in turn increases speculation, which then puts pressure on lenders to weaken their terms and get more heavily involved. Exactly this happened in the secondary banking crisis in Britain in the early 1970s (Clarke 1981). There too, fringe banks seeking to establish themselves lent over-generously and over-comprehensively to the property sector, in some cases taking equity in development companies in the process and thereby greatly enhancing their exposure. Although the British financial institutions had to be rescued in the short term and gradually closed down, restructured and sold off, deposits were not protected as extensively as in America. This encouraged even worse abuses, including more or less open theft. Nominee loans, for example, were widely used, in which a front man borrowed in order to pass the money on to a third party affiliated to the lender, perhaps a company owned by it. Insiders from one institution could exchange loans with insiders from others.

Land could be artificially sold and resold at ever higher prices through a string of covertly associated parties, before finally being used at a grossly inflated price as security for a loan. This technique, called land-flips in America, is known as back-to-back sales in Britain, where it is a common technique in mortgage fraud (Clarke 1992). Linked financing involved savings and loans in attracting large deposits by the covert offer of a large loan plus the commission to the deposit broker, who then defaulted on the loan (Calavita and Pontell, pp. 323–4). By this stage it is continuing to do business which is recorded in the institution's annual report as deposits and loans, which is the important thing, not the quality of the business. Many of the operators must have been aware that failure was inevitable.

The question was how to put it off for long enough. In part they could rely on the prevailing ideology of market liberalism and deregulation, and in part too on the very failure which they were making worse. The weakness of the FHLBB and the bankruptcy of the FSLIC by the early 1980s worked in their favour. In 1981 the FHLBB introduced new 'regulatory accounting procedures', which allowed assets (loans) to be understated and capital to be overstated. Thus institutions could be made to look healthy with regulatory approval, and would not need intervention and restructuring, which there was no cash left for in the FSLIC. The FHLBB took until 1985 to specify rules for accounting for ADC loans, and in the meantime they could be classified as either loans or investments according to which best suited the balance-sheet. All of these factors served to slow the process of investigating savings and loans which were in trouble, and to delay closing them down and prosecuting offenders.

Savings and loans heads also exercised substantial influence over regulators both collectively and individually. The regulatory board of the FHLBB was made up almost entirely of people from the industry, and it was said that the League of Savings Institutions exercised great influence over the appointment of the head of the FHLBB (Calavita and Pontell, p. 351). Entrepreneurs, including those who headed some of the most outrageous operations, would exercise direct influence by hiring regulators at fancy salaries, by funding politicians' election campaigns, and by lobbying extensively to divert and delay investigations. In the meantime, the lavish lifestyle of senior executives included indulging those with influence in parties, travel and other benefits. Finally, regulation was divided and structurally flawed, greatly reducing the chances of concerted and effective action. Before the reform of regulation in 1989 in the Financial Institutions Reform, Recovery and

Enforcement Act (FIRREA), regulation was split between the twelve district banks' inspectorates, the Office of Regulatory Activity, set up in 1986 to oversee them, the Office of Enforcement at the FHLBB headquarters, to whom district examiners reported, the FHLBB Board, and the FSLIC, which dealt with insolvencies. All this was federal regulation; state regulation was additional and largely independent. Further, the FHLBB was responsible for both promoting and regulating the industry, and the district banks had both to provide banking services to savings and loans in a reciprocal business relationship, and to provide the examiners who were the front-line inspectorate. It was this structural flaw that made it natural that savings and loans personnel dominated the boards of the district banks. There was hence little need to capture the regulators: influence if not complete control was built in.

We have seen a similar flaw, with similar results, in Gunningham's (1987) study of the Australian asbestos mine. Carson, in his account of North Sea oil exploration (1982) also shows in detail how successful lobbying by the industry for the location of the new inspectorate in the petroleum exploration division of the Department of Energy rather than in the Health and Safety Inspectorate, on the grounds that oil exploration was a radically different environment from land-based industries, produced similar flaws. Although the claim was that oil drilling posed exceptional and special hazards, which required a special inspectorate, most of the accidents were identical in nature to those occurring in factories and construction sites, but at a considerably higher level than on land. It was not until the enquiry into the Piper Alpha disaster in 1988 in which a massive explosion killed 167 people that the oil platform inspectorate was transferred to the HSI.

When matters could no longer be concealed, the extent of abuse among savings and loans was enormous. The number of cases referred for prosecution by the FHLBB in 1987 was 6205 and there were a further 5114 in 1998, a year in which the FSLIC closed or sold 220 savings and loans and had a further 300 awaiting attention. The costs of the rescue are constantly revised, but are measured in hundreds of billions of dollars, with fraud, theft and false accounting involved in three-quarters of insolvencies. Regulation of savings and loans had almost everything wrong with it, as we have seen, but the most serious factor, which actively promoted abuse, was the transformation of permitted ownership and activities of institutions, enabling them to take huge risks, while at the same time increasing the extent of government protection for deposits. This criminogenic feature of regulation has been identified quite widely (Clarke 1994a) in both private and state regulation.

Criminogenic regulation

Denzin (1977) for example, found that the American liquor trade was seriously distorted by the legacy of Prohibition. Although repeal in 1933 was achieved by arguing that legitimation would end the rackets and that taxes from alcohol would be highly beneficial to the public purse, the powerful sentiment behind Prohibition persisted and had to be appeased through regulation. This sentiment perceived alcohol and its distribution as a powerful corrupting influence, not only of the morality of the individual drinker, but of the political system, as the revenues from the industry could be diverted to political ends and bars and taverns used as centres where votes could be mobilised, as they usually were in areas run by machine politics. It was therefore insisted that wholesalers be maintained as a third tier of the industry between retailers and distillers, and that each tier be protected from the influence of the one above by regulation. Further, licensing laws about age-limitations, retail sales and bars were to be strict to control consumption. None of this took account of the fact that the industry emerging from prohibition was dominated by four distillers, who had been big enough to survive the 15-year ban, nor of the powerful pro-alcohol sentiment that had made Prohibition unsustainable. The result was the creation of a regulatory system that was over-extensive and widely flouted and the covert establishment of coordinated control by the distillers right through the industry to the retailers. It was not simply, Denzin argues, that regulatory aspiration took no account of the industry reality of oligarchy, but that detailed regulatory measures were created which commanded little practical public support: rules were made to be broken.

Clinard (1952) developed a similar argument in respect of the American wartime black market. The Office of Price Administration, which policed the emergency controls on prices and trading, was not only understaffed and incapable of effective enforcement, but held in contempt by many businessmen, who ridiculed its complex rules, and in any case saw no need for its restrictions. Once again too much regulation without obtaining full public support for it, coupled with a restricted capacity to enforce, inevitably led to ineffectiveness. It was also criminogenic in creating rules that were made to be broken, often outlawing what before had only been unethical and often widespread practice.

> Basically the black market appears to have been related to many practices current among certain elements of business during peacetime.

> Some of the black market represented 'normal' business procedures which were outlawed by the government, while others represented unethical and illegal behaviour which the government attempted to deal with in peacetime on a limited scale, and whose extensiveness was probably accentuated by the war. Among the practices which might be termed 'normal' in peacetime were tie-in sales of certain commodities, the giving of excessive discounts or kickbacks to favoured customers, and a certain amount of quality deterioration in products, particularly through upgrading. (p. 299)

These might be called examples of formal criminogenesis, as opposed to the substantive kind evident in the savings and loans scandal, though the effects in creating an ineffective regulatory system with unrealistic and unclear objectives, weak public support and poor enforcement is important. Substantive criminogenesis has been identified in private as well as state regulation. Studies of the American car industry, for example (Leonard and Weber 1970; Farberman 1975), noted the increasing pressures on dealers exerted by manufacturers, which led to a series of abuses of customers. In particular the creation by manufacturers of competition among dealers to minimise repairs done under warranty led to dealers refusing the accept their obligations to customers in the attempt to win the manufacturers' monthly prize.

More substantially, Brady's study of arson in Boston (1983) revealed the vital role of bank 'red-lining' of rundown districts where they refused to lend. This starved poor areas of capital and contributed to a downward spiral of property values which were then increasingly vulnerable to arson as the only means of realising their value. The insurance solution was made the more likely by local insurers also red-lining areas, leaving cover to be provided under laws requiring citizens to have access to fire insurance, which involved either collective schemes run by the insurance industry, or recourse to out of state insurers who were unaware of the enhanced risks. Not surprisingly, criminals, including professionally organised groups, became involved in setting up arsons and whole tracts of the city were subject to extensive and repeated fire damage.

Szaz provides a similar example of criminogenic state regulation creating opportunities for organised crime (1986). He analyses the implications of the Resource, Recovery and Conservation Act 1976, which created much tougher standards for toxic waste disposal following the scandals involving grossly polluted and unregulated sites in the 1970s.

Regulations for the disposal of ordinary waste were not too onerous, but those for toxic waste were made very demanding in order to ensure public safety. The difficulty this created was that disposal sites required investment and careful management and hence became very much more expensive. Investing in the work necessary to obtain a toxic waste-disposal licence hence became unattractive except to organised crime. Crime syndicates in some areas, especially in the north-eastern states where there has historically been a good deal of heavy industry, were well-established in domestic refuse collection and disposal contracting, and had extensive corrupt political connections. It was hence only too easy for them either to offer business deals to dispose of toxic waste, which they then dumped illegally, or to obtain licences for toxic waste disposal corruptly and to run sites which were not safe or properly maintained. As Szaz points out, it was critical to this outcome that business was successful during the passage of the regulation in resisting liability for their toxic waste once it had left their premises. Initially it was proposed that those who generated such waste should be responsible for its safe disposal. Industry succeeded in shifting the burden to the disposal agent, however, so creating an ideal opportunity for the criminal syndicates. Had the burden remained with the industries it is much more likely that they would have cooperated in setting up and running disposal sites for their collective benefit, and accepted the costs.

Criminogenic regulation is at the extreme of ineffectiveness. As Grabosky (1995) has shown, there is a variety of ways in which regulation can be counter-productive. Some of his examples are not very substantial, and there is a danger that once we have recognised that regulation can be ineffective, we can identify ineffectiveness and even counter-productiveness everywhere. Almost all regulation will be imperfect, and even if it works quite well initially it may fail to develop in the ways necessary over time, or be subjected to an erosion of political support and of funding. All regulation involves costs, not just in the direct sense but in the sense that to regulate is to constrain and restrict. At times these costs may be significant, a problem Grabosky calls spillover. Improved standards of safety and pollution emission can result in some businesses closing, so creating unemployment. Strict enforcement of building codes can render low-income private housing unfit for habitation and so reduce the availability of accommodation for the poor. Policies to discourage illegal immigration which involve placing the onus on employers to determine employees' legal status accurately can result in a refusal to employ ethnic minorities. Other significant counter-productive effects include the creation of fear and anxiety by giving public attention to a hazard through regulation, a central feature of the BSE affair, and the creation of self-fulfilling prophecies, a major problem when intervening in financial institutions when they are in difficulties, because this will probably lead to loss of confidence which will ensure their collapse. Regulation can also displace a problem, as has classically been the case with smoke-stack pollution and the generation of acid rain in countries ever more distant the higher the chimneys are required to be built. Even more effective initial policies can create new ones: thus the ban on DDT led to the replacement of these pesticides with organophosphates which posed different and in some respect greater risks; a move to electrically powered vehicles would create problems associated with the much more intensive use of lead for the batteries. Finally, perverse incentives may be created by some regulatory schemes, for example the payment of a bounty on the bodies of pest animals can lead to them being bred in order to claim the bounty; emissions trading systems for pollution control can penalise the most compliant and advantage the least compliant.

Multiple enforcement

We have noted at several points the problems posed when several regulators have an interest in the same regulatee. Their requirements can lead to conflicting demands – floors to be regularly washed for hygiene reasons and for them to be kept dry for safety reasons, for example. Much greater difficulties arise when something goes seriously wrong, since in the first place the government may order a special enquiry or parts of the legislature such as a congressional committee may initiate one, and in the second, the police and prosecutorial agencies may decide that regulatory failings are so great as to constitute criminal offences. Victims, if they are of an immediate and identifiable character, may also mount civil and even criminal suits, as for example, in the case of the loss of the channel ferry, *The Herald of Free Enterprise*, as a result of sailing with the bow loading-door open. Relatives of the victims organised an (unsuccessful) attempt to prosecute the owners, P&O, for corporate manslaughter. The question which arises in these complex cases is which set of proceedings is to have precedence over which others and, in the light of that, the extent to which evidence secured in one enquiry can be used in another, notably criminal prosecution. Finally questions arise of sanction, compensation and recovery of assets. These problems arise with any substantial disaster, but they are often even more complex in financial failures. Two examples, one hypothetical and one real, serve to illustrate the way in which regulation that may be effective in routine cases may become bogged down in large cases. Multiple enforcement, or 'parallel proceedings', as lawyers call it, is a problem that increases as regulation increases and is being faced by governments, who are looking for a way of organising priorities. It was an issue addressed by the Lord Chancellor in the light of the review of regulation of the financial sector and the coordination of the whole sector under the new Financial Services Authority (Irvine 1998). The aspiration to a unified approach to regulating the financial sector was established. The Lord Chancellor offered the following example as a way of illustrating the difficulties which arise:

> A listed English bank, with international commercial lending, private and investment banking arms, is taken over by a large American bank. This follows a contested bid which saw massive dealing in the bank's shares before and after the take-over. The bank's commercial lending portfolio includes secured lending to corporations in Ruritania, one of the so-called 'bull economies'. Proper provision seems to have been made for this. The bank's personal investment arm sells high yield personal pension policies linked to the equity markets of these 'bull economies'.
>
> Disgruntled ex-employees, redundant after the take-over, make contact with friends in the media. Stories of irregularities in the bank's conduct begin to appear. There are allegations of undue closeness between the bank and its major customers. Meanwhile, Ruritania's economy crashes, leading to mass unemployment and civil unrest.
>
> The bank's new auditors, brought in by the American parent, uncover substantial lending to Ruritanian customers, disguised through shell companies in various off-shore jurisdictions. Provision in the accounts appears wholly inadequate. The previous directors may have turned a blind eye to the absence of proper credit controls. They may have made misleading statements about the bank's financial performance at the time of the take-over, to manipulate the share price. Doubt is cast on the objectivity of previous audits.
>
> Investigation by the FSA and PIA reveals that those pension policies, sold by the bank, are not linked to the 'pool' of 'bull economy' equities at all, but, rather, to equities in Ruritanian corporations which are customers of the bank itself. As the City reels from the bank's rapid implosion, the Secretary of State for Trade and Industry appoints inspectors to investigate the affairs of the bank and dealings in its shares.

At this point the bank issues proceedings against its former auditors for negligence, and against its former directors for fraudulent misrepresentation. Mareva injunctions are obtained against the former directors, freezing their assets and restricting their spending on legal costs.

The pensioners demand to be told how the regulators failed to spot the fraud. The Government appoints a Lord Justice of Appeal to begin a cross-departmental Inquiry into the bank's demise. The Inquiry hears much oral and written evidence. But this is unavailable for use in any subsequent proceedings, because of Public Interest Immunity. The Lord Justice's final report is inadmissible in any such proceedings, since it is deemed to be opinion evidence only.

Meanwhile, the Serious Fraud Office begins its investigation, seconding accountants from one of the major firms. It raids the bank's main offices, and uncovers what it believes to be false accounting. The bank's former directors are interviewed and charged.

After numerous complaints, the Institute of Chartered Accountants begins an investigation into the conduct of the bank's former auditors. Unfortunately, it cannot find a major accounting firm to act for it – because by this stage they are all conflicted out. In any event, the auditors successfully judicially review the ICAEW's refusal to postpone its inquiry, pending the civil action. The civil action is itself stayed, pending the criminal trial, as are disqualification proceedings against the former directors brought under the Directors Disqualification Act 1986.

After two years, the criminal trial reaches preparatory hearings. The number of defendants and the complexity of the charges requires a series of trials. The directors begin proceedings which eventually reach the European Court of Human Rights, alleging a breach of their right to a fair hearing within a reasonable time.

(Irvine 1998, pp. 3–4)

Eight separate sets of proceedings with various objectives and implications for public policy arise from the example – punishment of offenders, recovery of assets, understanding what went wrong, protecting the public, eliminating incompetent professionals, and so on. Though fictitious, the Lord Chancellor's example drew on the unhappy experience of previous governments with such large and complex cases as the Guinness and Maxwell affairs, which particularly highlighted the problems associated with criminal prosecution in such cases: they take years to come to court and are so complex it is hard for juries to understand, run for months in court and even then may not achieve convictions (Clarke 1998b).

Where the case has multinational dimensions, matters become even more lengthy and complex, a matter to which we shall return in the next chapter. Where, as in the case of BCCI, an organisation deliberately establishes itself in several jurisdictions, some, such as the Cayman Islands, with deliberately very limited regulation, and sets up its head office in a small European state with inevitably limited powers of investigation and enforcement, Luxembourg, regulatory arbitrage is exploited to the full and the malefactors can escape scrutiny for a long time (Bingham 1992; Truell and Gurwin 1992; Kerry and Brown 1992). BCCI operated in over 70 countries but it did much of its business in London and America. There were hence great difficulties in reaching an agreement on how to deal with the bank when it crashed in 1991. After extensive negotiations a global settlement was nonetheless agreed between the US government, the New York District Attorney, the BCCI liquidators in London and various parties in Abu Dhabi, which ultimately became the source of a substantial pay-out. It would seem that the vast extent of BCCI's misconduct and the sums involved, together with the immense complexity of resolving the issues, galvanised the various parties into recognising that, unless an agreement was reached, there was almost no hope of progress and no one would be satisfied. But, as Rossbacher and Young (1998) point out, 'the global resolution disposed of BCCI's assets without reference to the BCCI victims who remained unrepresented and voiceless in the proceedings' (p. 365). It was explicitly agreed in 1992, when BCCI pleaded guilty under American racketeering legislation (RICO), that half the sums recovered would go to the global liquidation fund and the other half to the Attorney-General for disbursement at his discretion.

While some of this found its way to the victims, Rossbacher and Young detail an extensive list of payments to the US state and regulatory agencies, despite the fact that, under American law, depositors in bankruptcy proceedings stand higher in order of precedence than the government. When victims attempted to press their claims through the courts, they were denied, largely on the grounds that the global settlement could not be compromised. The BCCI case illustrates that multiple proceedings do not only result in delay and confusion to the disadvantage of victims and of effective regulation. In this case cutting through the confusion in order to make progress put the most powerful parties in the negotiating process in a privileged position. Depositors had to wait several more years, until a substantial contribution was made by Abu Dhabi, to receive significant restitution. Multiple enforcement is hence a serious problem compromising regulatory effectiveness in just those major cases where it needs to demonstrate efficiency and competence, not only to deal with disaster but to sustain public confidence in regulation.

Conclusion

The import of the examples considered in this chapter is that effectiveness is an issue to be taken seriously. Only too often it is relegated to ideological skirmishing. On the one hand the pro-regulators are anxious to intervene, to be seen to be acting and to respond to the call that 'something must be done about it'. On the other hand, the *laissez-faire* sceptics immediately point to the costs, limitations and inadequacies of the regulation, and the lack of understanding of the regulators. Such complaints are often self-serving and reflect a desire by regulatees to be left alone to pursue their own ways regardless of the interests of others and the burdens these ways may impose on them.

There are no easy solutions to the problems of effectiveness, which is why this chapter offers no recipes, though it has sought to identify some of the major hazards. That it is easy to identify ineffectiveness with hindsight should alert us to the need for regulatory review. The danger with all regulatory agencies is that they develop a vested interest in their patch and in their own reputation, and will naturally seek, if they can, to run a regime of self-fulfilling virtues: regulation will be conducted so as to demonstrate that there remains a significant problem to be controlled and to show that the agency is achieving significant success in doing so. Review arrives far too often as the result of manifest regulatory failure, and it is not easy for politicians to find the time for critical review when an agency appears to be performing competently. This in turn counsels caution when the opportunity for regulation and review arises: regulate in haste, repent at leisure. The difficulty is that this is something of a counsel of perfection. It often needs a head of political steam to generate the impetus to overcome opposition and provide the resources for regulation. To maintain that, at those points, careful consideration should be given to how the proposed regulation is to get results and how far it is realistic to expect it to get the dramatic changes often insisted upon, is to play into the hands of those resisting regulation and negotiating for it to be set up in a limited and weak form that will cause a minimum of trouble. The only means of addressing this conundrum – and there is no direct solution for it – is for those with experience in creating, administering and reviewing regulation to be actively involved in advising on new initiatives. As regulation becomes ever more widespread and varied, this experience will grow, and perhaps some of the flaws born of naivety will be avoided, and so the more catastrophically ineffective and criminogenic examples reviewed here may not be repeated.

7
International Regulation

Writing at a time (late 1998) when talk has been of world financial crisis in the wake of the disarray of Japan and many of the former tiger economies of the Far East, and with Russia requiring food aid to cope with continuing economic chaos, the need for international regulation is clear enough, and was coherently articulated by the British government in calling for immediate remedies and for a long-term world-wide financial regulator. In this context it is only too easy to see the answer to the question as to why international regulation should seemingly be ever more extensive and apparently necessary in an adaptation of President Clinton's remark: it's globalisation, stupid.

Such a reaction is supported by other global issues now taken for granted, such as climate change, addressed at world summit meetings at Rio, Kyoto and Buenos Aires. Further reflection on both issues should give us pause, however. A major difficulty in obtaining general agreement on action about global warming has been to convince Third World countries to stop cutting down forests, which they see as a piece of altruism far from reciprocated by the developed world, which consumes vastly greater amounts of energy. The USA in particular, by far the greatest consumer, has proved extremely reluctant to commit itself to reductions in greenhouse-gas emissions. One is reminded that problems may be global, but that power resides firmly with nation-states, and largely with the bigger and more industrialised nation-states.

The world may have become the communications village that McLuhan envisaged in the 1960s and which has led to constant trading on the world's stock, currency and futures markets, but no substantial institutions exist to regulate them internationally. For a quarter of a century since President Nixon abandoned American exchange controls in 1972 and allowed the dollar to float on international currency markets, the world financial system has survived on faith and hope, though with little charity. In practice the power of the dollar as an international reserve currency formally agreed at Bretton Woods at the end of the Second World War and informally terminated by Nixon's action, has allowed financial transactions to continue. Half a century after Bretton Woods, however, the almighty dollar is only mighty thanks to the very success of the world economy and the enormous economic development of increasing numbers of nations. It may be that we are now at a point where one country can demonstrably no longer act as banker to the rest of the world, still less impose its terms successfully on all or even most quarters, and hence that world financial regulation is necessary. That is a very different matter from agreeing on a collective system, and different again from submitting to its less convenient requirements when in operation. Globalisation may be the word on many lips, but it is no more than a fragrance in their nostrils until it is stabilised through global institutions. Until it is, every difficulty will result in a retreat to the trusted and established structures of the nation-state, with remedy seen to lie in multinational alliances rather than binding international conventions.

A theme of this chapter is hence the tension between the need for international regulation in an increasing number of areas, and the continuing power of the nation-state as the established structure of the world politically, and still to a substantial degree economically. That entails all the cultural baggage with which the nation-state has grown so powerful and continues to be a basis for the establishment of new ones: religion, language, ethnicity, geography and all that goes to make up a sense of identity, a mere idea one might complain, but one powerful enough to lead to regular warfare to sustain it, because grounded in the categorisation of 'us' versus 'them'. Despite aspirations since the Renaissance, there are still now no more than an isolated few citizens of the world.

Perhaps those citizens will before long arise out of the financial sector, since it is there that globalisation has been progressing fastest and in a manner which not merely challenges national boundaries but impinges on nationhood. Global trading in stock and financial markets developed in the 1980s but on the basis of a continuous transfer between time zones, with national markets in New York, London and Tokyo closing overnight. Those markets continued to operate on the basis of face-to-face exchange, as we saw in Gunningham's review of the derivatives markets in Hong Kong, Sydney and Chicago (1991). Electronic trading is progressively superseding the physical trading-floor, however, and once this is achieved there are limited obstacles to creating integrated international electronic markets, principally national pride, local practice and incompatible computer systems. In the late 1990s these were being overcome. An alliance between the London International Financial Futures Exchange (LIFFE) and its Frankfurt counterpart was the beginning of a process of international integration, with German, Swiss and French derivatives exchanges discussing it, and Chicago also contemplating coming in (Dixon 1998). With a quarter of all New York trade already on the Internet, and larger companies unhappy at having to organise separate listings in the world's major stock exchanges, the pressures to breaking with national systems was set to increase.

Yet the prospect of unified constant global stock and derivatives markets only increased fears of a sudden global crash if confidence were threatened. The extreme volatility of markets in 1998 in reaction to the crises in the Far Eastern economies was severe enough to stimulate warnings of a possible global recession as a result of the knock-on effects to other countries with substantial investment exposure. The reasons for the crises were depressingly similar: overlending on property leading to unsustainable speculation, over-intimate relations between politicians, officials, businessmen and bankers with extensive cronyism and rampant corruption in some cases, leading to imprudent lending, made worse by throwing further good money after that which had gone bad. What were the foreign, mainly western, banks and investment funds doing to expose themselves to this endemic abuse? They were assuming that because such abuses were substantially restrained in their own countries, they would be in the tiger economies, and so contributed to the mythology of their miraculous growth. Perhaps more significantly, they committed themselves because others were doing so, their anxiety not to miss out on an opportunity for profit overcoming their sense of prudence as to the unanalysed and under-investigated nature of the risks. Global trading with global consequences was shown to be taking place, with only national regulation, very variable even in its aspirations, and evidently ineffective even in western nations in restraining folly.

That term is not used lightly. A number of banking executives who profited from the boom in the 1980s in New York, and whose antics were so entertainingly described by Michael Lewis in *Liar's Poker*, surfaced again in the Asian-precipitated crisis of 1998. They had formed a hedge fund, Long Term Capital Management (LTCM), investing their own money and taking on that of investors – a minimum of

$10 million for at least three years. By the time of the crash, LTCM had $4 billion with which it was speculating in the derivatives market at leverage ratios of up to 25 : 1, considerably in excess of the level a normal investment bank would permit. For some time LTCM succeeded and its returns were naturally great. When it finally got it wrong its capital shrank to $600 million and the Federal Reserve organised a rescue because of the heavy involvement of major bankers – UBS $1 billion, Merrill Lynch $1.4 billion, for example. The chairman of the Fed told the House of Representatives that this had contributed to averting a world financial crisis. But how could LTCM have been permitted to behave so recklessly for so long with so much of other people's money? He thought that hedge funds were adequately supervised (*The Times*, 3 October 1998).

This was by no means the first time banks had been shown to be imprudent on a grand scale. Their lending to third-world countries, many in Africa and former colonies, many there and elsewhere run by dictators from the 1960s onwards, reflected an appreciation of strong government as the basis for investment and growth, and ignored the reality of systematic corruption, which largely stifled growth, eventually led to civil unrest, and saw vast sums siphoned off by political elites into secure, offshore, hard-currency accounts. The outcome was massive foreign indebtedness, which by the 1990s had led to a situation where it was either unserviceable, or, if it could be serviced, frustrated further development by diverting the necessary investment. These problems were increased in the latter 1970s when western banks became awash with petro-dollars in the wake of the creation of OPEC, the oil cartel set up by Arab countries, which achieved a quadrupling of the price of oil. The knock-on effect of this piece of private international regulation was stagnation and inflation in western economies and the loan of the oil revenues deposited in western banks to third-world countries in large quantities, notably in Central and Latin America, in the mistaken beliefs first, that they were conveniently about to enjoy a surge of economic growth and secondly, that sovereign states, unlike companies, cannot go bankrupt and that therefore risks in lending are markedly less.

The only substantial financial institution at the end of the century was the one that had been established half a century earlier at Bretton Woods: the World Bank and the International Monetary Fund, an international lender of last resort sustained by regular contributions from the leading industrialised nations. Given American economic dominance this meant a substantial American input, and hence also influence over the practices and policies of the IMF. Nor does the

World Bank or any other international institution have any genuine authority over central bankers, though it obviously has leverage over those of the weaker nations when it provides funds for them.

Thus in the wake of the collapse of BCCI in 1991, it was the informal Basle Committee of central bankers to whom the issue of improving the supervision of international banks fell. The Committee is not an institution with independent authority, but merely a meeting-point for central bankers of the 11 industrialised nations, plus Luxembourg, to allow them to reach agreement on common concerns. It can hence only proceed substantially by unanimity. The Committee was formed in 1974 and reached an agreement in 1975 known as the Basle Concordat. Under that agreement, responsibilities for the detailed supervision of banks operating in countries other than their home base was clarified and the intention was that no bank should escape effective supervision and that information should flow easily about supervised banks between the relevant authorities. The Concordat was amplified in 1983, following the collapse of the Banco Ambrosiano in Italy. As protracted investigations eventually showed (Raw 1992) the Ambrosiano had comprehensively evaded Italian exchange controls and banking supervision, taking advantage of an alliance with the Vatican Bank, the Institute for Religious Works, which was exempted from Italian supervision and which was used as a conduit for money sent abroad. Both Bermuda and Luxembourg were exploited as financial centres more or less offshore and exercising limited oversight, to conceal massive frauds, some with Mafia sources. Clearly Basle One had not been effective and Basle Two elaborated responsibilities in a number of detailed ways and articulated four principles: that effective supervision required a review of the consolidated operations of a bank world-wide, that no foreign bank should escape supervision, that supervision should be adequate and that there should be exchange of information between host and parent-country to ensure adequacy. In cases of doubt, host countries should refuse a foreign bank the right to operate in their territory, or impose restrictive conditions (Bingham 1992, Chapter 1). If some of this looked much like a reiteration of Basle One, the cynical conclusion that it was mere collective exhortation rather than agreement was justified in respect of the collapse of BCCI.

BCCI: the Bank of Credit and Commerce International

BCCI had its holding company and hence its technical headquarters in Luxembourg, the smallest of the EU member states, with a population of only half a million and host to numerous banks with operations elsewhere, which it manifestly had not the resources to supervise comprehensively. When, in 1972, BCCI opened its London branch, the Bank of England had no formal power to block it. EC banking legislation was already being developed, and gave rise in 1977 to the Banking Coordination Directive which was designed to allow equal access to banks of member states for all countries in the EC, and banned the imposition of conditions on foreign banks that were not imposed on a member's own.

BCCI rapidly expanded its operations in London and established BCCI Overseas in the Cayman Islands, then growing rapidly as an offshore, tax-exempt financial centre. Attempts to buy banks in New York financed by BCCI in 1976–77 were rejected by the New York regulators on the grounds that there was no regulator responsible for overseeing its world-wide operations. Further rapid expansion took place in the latter 1970s, particularly in BCCI Overseas and more branches were opened in Britain, which appeared to be the main base of its business. BCCI was refused a full banking licence under the 1979 Banking Act, which had tightened the criteria for recognition, but the issue of where the bank was based was not successfully addressed. BCCI was run from London and did most of its business there, but was able to claim it was registered and had its headquarters in Luxembourg, so serving to frustrate the objectives of the Basle Concordat to get a clear agreement as to who the leading supervisor should be.

The stalemate over supervision was arguably critical to the continuance of BCCI's ruinous and corrupt career, which advanced again in the 1980s. It was eventually shown to be laundering drug money, acting as banker to terrorists, engaging in vastly imprudent lending, involved in the illegal purchase of an American bank, and subject to a variety of internal frauds and thefts, as well as systematic false accounting (Bingham 1992; Gurwin and Truell 1992). Large losses were discovered in BCCI's central treasury, technically part of BCCI Overseas, in 1988, and it was transferred to Abu Dhabi, where the bank enjoyed substantial financial backing. The option of transferring central supervision to Abu Dhabi was considered, but rejected as an unrealistic burden on the regulatory capacities of the UAE. As Bingham points out, by 1987 BCCI was trading in over 70 countries, in many of which supervision was weak or non-existent (1992, p. 47). The most realistic option for achieving regulatory control was for the Bank of England to shoulder the burden, but this would have required not only an uncharacteristically intrusive style, but an enormous input of staff, time and money. The Luxembourg authorities conveyed their dismay and inability to do the job which, with only 1 to 2 per cent of BCCI's business conducted in their territory, was scarcely a reasonable expectation in any case.

The solution eventually reached was an international experiment: a college of regulators to meet twice-yearly and be informed by the auditors. That this was the result of desperation rather than rational recourse was evident in the motley outcome: Switzerland and Spain, where BCCI did little business, were represented, but the Caymans, the UAE and Hong Kong, where it was big, were not. Although the college of regulators met regularly over the years until the coordinated closure of BCCI in July 1991, it was effectively overtaken by events in the first year of its operation. In October 1988 seven BCCI officials in Tampa, Florida, were arrested on drug-trafficking and money-laundering charges, as a result of an extensive American enquiry into its operations in Colombia, where it had acquired a bank in 1985 and in Panama, where one of its customers was the President, General Noriega, who was later deposed by America and prosecuted for drugs trafficking. From this point onwards there were successive revelations of the extent of BCCI's abuses, and its financial instability became a matter of constant concern. As information accumulated, the college of regulators insisted on the need for a capital injection of $100 million in April 1990, but this was followed by an auditors report showing a need for $1.5 billion in October. In response the bank secured capital from Abu Dhabi, which took its shareholding to over 75 per cent and hence made it the obvious centre for consolidated supervision. Benighted to the last, the Bank of England briefed the Chancellor of the Exchequer in April 1991 that BCCI's UK branches were 'in pretty good shape', only for a special report to the Bank by Price Waterhouse to reveal 'massive and widespread fraud' in June, leading to the bank's closure in July (Hall 1994).

There has not been space here to identify more than the bare bones of the regulatory failure in respect of BCCI, whose operations were vast and intricate, and its aftermath in litigation on behalf of depositors ($1.7 billion compensation, largely from Abu Dhabi, was agreed in 1992), with its auditors – Price Waterhouse and Ernst and Young – subject to disciplinary proceedings, and with prosecutions continuing in Britain and America, as well as civil litigation against BCCI officers. BCCI demonstrated just how comprehensively supervision could not only be side-stepped in the first instance, but evaded over the long term, despite the Basle Concordats and the lessons supposedly learned from Ambrosiano. Much the same could evidently be said of international banking regulation as Ghandi said of British democracy: 'I think it would be a nice idea.'

One might suppose that the peculiarly international nature of BCCI would act as a spur to the development of truly international banking regulatory institutions. Not so. The Bank of England did finally seem disposed to shift away from its informal trusting style and towards the more detailed scrutiny of banks by teams of examiners characteristic of America, and announced that it was markedly increasing its investigative staff. The more significant move has probably come in the separation of the inspection and investigation function of the bank from its other functions and the allocation of these to the new Financial Services Authority, which has similar responsibilities for other financial institutions. The Basle Committee was prompt in responding, issuing further guidelines on minimum standards of supervision in 1992. The most important of these asserted that 'all international banks should be supervised by a home country authority that capably performs consolidated supervision'. This was only a restatement. What was significant was the guidance given as to the meaning of 'capably'. This was to entail having the reliability of information on global operations 'confirmed to its own satisfaction through on-site communication or other means, and assess the information as it may bear on the safety and soundness of the bank', to prevent the development of corporate structures that obscure a consolidated appraisal of the bank, and to prevent the bank creating foreign branches in particular jurisdictions. Before agreeing foreign branches, host and home supervisors are to agree supervisory responsibilities and that they can be carried out effectively (Hall 1994, pp. 111–12). This is progress, but only modest and again there is more exhortation and expectation than effective control, and much unrealistic reliance is placed on the capacity of authorities in small and poorer states to appraise skilled, well-advised and substantial financial institutions comprehensively and accurately. Banks' secrecy provisions are not explicitly addressed, and there is plainly much room for differences of expectation in different jurisdictions.

There is also potential conflict with EC regulation in determining who is the home regulator required to undertake consolidated review, which is the country where most business is conducted, not that where the bank originates. Further, under the EC 'common passport' system, banks in member states are required to accept licensing decisions by others, making the kind of questioning interchange sought by the Basle Committee difficult to undertake. We shall return to finance and to the EC later in this chapter. The point for present purposes is that the objective of the EC/EU in overcoming national differences and achieving economic integration without accompanying political integration is leading to the creation of an unusual if not unprecedented entity, which may at times make the achievement of international regulatory controls less easy.

This discursus on the travails of international financial regulation has not attempted to be systematic, and has been intended only to highlight the difficulties and some of the complexities involved, despite the evidence of need. Achieving effective international regulation is generally even more difficult than achieving national regulation, and the problems arise in many quarters, though many are manifestations of concerns about sovereignty and the nation-state. Before coming to an example of substantial long-term failure despite persistent efforts in the latter part of this chapter, we will turn to two areas where there has been some success; first modest success despite great difficulties, and second, substantial long-term success though, as with all regulation, not without some difficulties and failures.

Nuclear power: some success against the odds

The term used to describe the catastrophic failure of a nuclear power plant has also been applied to the comprehensive failure of national and international financial systems: meltdown. Both refer to the totality of the event and its capacity to destroy everything and everyone caught up in its ambit. It is less easy, though instructive, to recall the combination of excitement and dread with which nuclear energy was surrounded for a quarter of a century following its first military public use. Nuclear energy was seen as the ultimate engineering and economic achievement of the century, offering the prospect of limitless cheap electricity without the need for the hazards of mining coal or the attendant pollution that hydrocarbon fuels produce. At the same time nuclear weapons were at the centre of the Cold War and its arms race, with NATO and the Warsaw Pact, followed later by China and its allies, building up a vast arsenal of weapons culminating in the MIRVed ICBM: long-range rockets ascending into the upper atmosphere and releasing multiple nuclear weapons with different targets. The outcome was the macabre state of mutually assured destruction (MAD), whereby the superpowers created a situation in which they could survive a nuclear first strike and hit back with their own weapons, generating enough devastation and fallout to destroy life on most of the planet.

Governments in many nations made extensive covert and more limited overt preparations for civilian and administrative responses to nuclear attack, efforts which were so feeble and ineffective in Britain as to provoke hilarity, but which in America led to a modest industry in the construction of backyard fallout shelters.

Against this background, the international regulation of nuclear power was bound to be profoundly equivocal. Even though nuclear power-station operation does not provide the knowledge to construct nuclear weapons (still less to deliver them), they do create very hazardous materials, some of which can be upgraded to nuclear-weapons level. Although nations like Britain, France and America, which had ambitious nuclear power programmes in the 1950s and 1960s, emphasised the cheap energy benefits and even the export potential, some at least of the plants were used for the processing of weapons-grade material. For this reason as well as the hazards of radiation at plants, they were surrounded in military-level security and secrecy and information on accidents and leakages, even quite severe ones such as that at Windscale (Sellafield) in 1957, were kept from the public.

It is perhaps not surprising then, that the International Atomic Energy Agency was founded in 1956 at the height of the Cold War as an independent agency reporting to the UN. It is authorised to:

- encourage and assist research and development and practical application of atomic energy for peaceful purposes
- to make provision for materials, services and equipment and facilities to meet the needs of research and practical application
- to foster the exchange of scientific and technical information on peaceful uses of atomic energy
- to encourage the training of scientists and experts
- to establish and administer safeguards designed to ensure that special fissionable and other materials, services, equipment and facilities and information made available are not diverted for military use
- to establish, in consultation or collaboration with the competent organs of the UN and the specialist agencies concerned, standards of safety for the protection of health and minimisation of danger to life and property
- to acquire or establish facilities, plant and equipment which are deemed useful for the implementation of its tasks.

Activities are to be conducted in conformity with UN policies of 'safeguarded world-wide disarmament'. If the objectives listed above sound rather idealistic, the latter provision in the context of the greatest arms-race in history is absurd. Nonetheless the agency has played a useful role in a number of ways. It has disseminated information on nuclear safety and established codes of safety practice; it has also set up safeguard procedures to prevent the diversion of nuclear materials for weapons purposes, a role enhanced by the Nuclear Weapons Non-Proliferation Treaty of 1970, to which a large number of states signed up. The agency administers a special treaty designed to maintain a ban on nuclear weapons in Latin America and the Caribbean, and reached agreement with the UK, France and the US between 1978 and 1981 on safeguards with the USSR in 1985, and with China in 1988. Not all states signed up to the Non-Proliferation Treaty, and Pakistan and India demonstrated their acquisition of nuclear weapons in 1998 with test explosions. Israel is widely assumed to have a nuclear-weapons capacity, as did South Africa, whose abandonment of them was verified by the agency in 1993. The agency only established safety-inspection teams to visit power plants on request in 1982, too late to gain the acceptance necessary to prevent the accident at Chernobyl in 1986. That accident led to much greater access for agency inspectors. In recent years the agency has become more active, monitoring a power plant in North Korea, whose development was frozen after claims that it was being used to create weapons-grade material. The agency is also involved in monitoring Iraq's nuclear facilities under the terms of the UN Ceasefire at the end of the Gulf War in 1991, though it should be recalled that it was the Israelis who attacked and disabled Iraq's nuclear power plant just before it was due to come on-stream in the 1980s. The agency has also been involved in attempts to prevent the dumping of nuclear waste from 1987.

Clearly the practical powers of the agency have been severely limited for most of its existence. It is worth reflecting on the facts, however, first that nuclear weapons have not spread as widely as they could have, given advancing economies, and second that nuclear power has been developed in a large number of countries, with only a limited number of serious accidents. The IAEA now has 120 members, including all states using nuclear power, and has 850 nuclear power plants subject to its safeguards in 95 per cent of the world's nuclear facilities. Given the sensitivity on matters nuclear throughout the Cold War, this is an achievement that has certainly been beneficial and an indication that even where the interests of nation-states are manifested in their most extreme form in areas involved with preparation for war, international regulation is possible, albeit in a modest way. Its very persistence has made the implementation of the more cooperative arrangements that exist today the easier to implement.

Shipping: substantial success

As Zacher (1996) remarks in his comparative study of shipping, air transport, telecommunications and the mail, these services are essential to the global economy. All deal with transit through the air and water spaces above and between nation-states and hence have posed stark options to states as to whether to respond defensively or to collaborate on a mutually advantageous regime. International trade has been a long-term source of national economic growth. In the latter 1980s two-thirds of international trade by value and 95 per cent by weight were shipped by an industry earning $140 billion per year and employing 1 million people. The quite developed collaborative regime that exists today has developed in a number of stages.

Up to the nineteenth century, aspirations to project military power overseas and to exercise control over trade to a powerful nation's advantage persisted. Imperial expansion and the development of navies, along with wars, sustained the notion that control of the sea, while not as vital as control of the national land territory, was a considerable asset. Against this, it was evident that control was dependent upon overwhelming naval superiority, which was expensive to maintain and apply in a policing role, given that there would be many competing claims to the seaways. The end of the Napoleonic wars in 1815 may have ushered in an international *pax Britannica* in which the Royal Navy exercised considerable influence throughout much of the world, but the industrial revolution and the advent of steam-powered ships, with their greater speed, reliability and carrying capacity, gave an immense boost to international trade, and opinion settled decisively in favour of freedom of access to the high seas, that is, the international waterways beyond the accepted three-mile territorial jurisdiction. This trade involved 2.3 million dead-weight tons in 1815; 23 million dwt in 1870; 82 million dwt in 1922; 326 million dwt in 1970 and 638 million dwt in 1989.

Once the principle of freedom of access to all to the high seas was accepted, several other important principles flowed from it: the right of innocent passage through territorial waters, subject of course to greater scrutiny in times of war, tempered by local state control of the coasts and harbours, and flagstate jurisdiction on ships, that is, the principle that, since the high seas are not national territory, jurisdiction over ships on them is determined by the nation with whom they are registered. This rule does, however, mean that flagstates are responsible for enforcing the law on their ships, including laws deriving from international agreements on shipping.

This has had important implications for an issue that has become of increasing importance in the twentieth century: damage control whether to, or as in recent years with oil spills, by ships. Until the establishment of larger, faster, more reliable steam-ships at the end of the nineteenth century, shipping loss was taken to be a routine hazard, a result of the forces of nature and the prudence and foresight that shipowners and masters were willing and able to deploy. Pressure was exerted in this direction by the rise of shipping insurance in the nineteenth century, with insurers naturally concerned not to increase their liabilities by offering cover to unsafe vessels. Britain's dominance as a world maritime power and her capacity to enforce her standards in the many ports she controlled, led to British legislation on safety standards being widely accepted, although the first international agreement dates back to the 1889 Washington Convention on collision prevention rules. It was the loss of the *Titanic* in 1912 that gave real impetus to this issue, however, and led to the Safety of Life at Sea convention in 1913 (SOLAS), the first of a series that have been revised and extended to the present and now cover 95 per cent of merchant ships. The convention was extended in 1929 and there were additional international agreements on collision prevention (1910), maritime radio communications (1906) and signals (1930), and on load lines (1930).

The other area in which agreement became increasingly necessary was compensation in case of damage, which was addressed under the collision-damages rules agreement of 1910, rules limiting the liability of owners of vessels in 1924, and rules unifying vital documentation for ships' cargoes, bills of lading, in 1924. Compensation and liability posed a serious problem of differences between the laws of different states, which was taken up by the Comité Maritime International, a private organisation of lawyers, from 1897. This has acted as a vital forum in the preparation drafts of international agreements that can be accepted by all parties. The problem persists and today the CMI works with the two UN agencies concerned with trade and private law. Despite the difficulties in reconciling national legal systems, there has been a strong interest in reaching agreements and 20 have been achieved in the twentieth century covering liability, financing, salvage and some matters of criminal jurisdiction.

There were attempts to establish a permanent body to deal with international shipping, but these were frustrated by concerns among some states that their freedom of action would be constrained, with implications for trade competition. It was not until 1948 that such a body, the International Maritime Organisation (IMO), was agreed under the auspices of the UN. The IMO has been mainly concerned with safety and pollution controls, and has been the focus for successive revisions to SOLAS, both in comprehensive new conventions, and amendments, beginning in 1948. An agreement on oil pollution convened by the UK in 1954 was amended by the IMO in 1962, but a new crisis arose with the loss of the *Torrey Canyon* on the south coast of Britain in 1967 and the heavy pollution of the sea with her cargo of 120 000 tonnes of oil. With tanker sizes increasing from 30 000 tonnes dwt in the 1950s to over 500 000 tonnes in the 1970s, oil pollution was clearly a rapidly increasing hazard. It was manifested in a variety of ways: in spillages at loading and discharge, in discharges as a consequence of washing out tanks at sea, as a result of major spillage because of collision or other accident, and in matters of liability for compensation and clean-up costs (IMO 1998). All these matters were addressed directly and indirectly. Although major spillages were locally devastating, discharges from the washing-out of tanks polluted coastlines very widely, especially in areas of busy shipping lanes. This has been substantially reduced by the introduction of a convention since 1978 requiring washings to be pumped into a separate tank where oil and water can separate during the trip to the terminal and then the water discharged without pollution. Collision damage and loss risks were addressed by a convention in 1977 and traffic separation schemes were agreed and introduced for north-west Europe, notably the Straits of Dover, with the result that collisions fell from 156 between 1956 and 1961 to 45 between 1976 and 1981. Radio communication was improved by the introduction of satellite communications, which led to a separate agency, INMARSAT, to manage them in 1976. A variety of regulations and conventions on civil liability and compensation were adopted in the latter 1960s and 1970s and new equipment and construction standards for ships in 1973, 1978 and 1990, the latter in the light of the oil-spill from the *Exxon Valdez* on the Alaskan coast with its fragile ecology, which led to the acceptance of mandatory double hulls or their equivalent. The US, as the leading oil-transporter and world shipping power, succeeded in achieving more stringent and expensive standards than other nations wanted, but by this point international commitment to agreed and reasonably effective rules was well established (Zacher 1996, p. 59).

While there have been significant areas of long-term progress in the international regulation of shipping, of which only some examples have been given above, and growing acceptance on the benefits of agreed international arrangements to avoid the frustrations resultant from piecemeal national enforcement, there have been significant areas of difficulty, which in different ways reflect the limitations of the regime. Three are instructive; flags of convenience, maritime crime, and roll-on–roll-off ferries.

Opinions vary as to how great a hazard is posed by flags of convenience. Seafarers' representatives would point to the considerable weakness in the requirements of convenience flags for adequate training and pay of crews and adequate manning levels, restraints on hours worked and maintenance of ships and their vital equipment. Major companies using flags of convenience would point to the high standards maintained in their fleets, comparable with those of the major western shipping nations' requirements, and claim that resort to flags of convenience is made necessary by tax and other financial considerations, and that competitive pressures make it necessary. There is no doubt that registration with flags of convenience has increased rapidly in recent years. Between 1970 and 1989 the share of industrialised countries fell from 65 to 32 per cent, that of developing economies rose from 6 to 21 per cent, and that of flag-of-convenience countries rose from 29 to 35 per cent, with Liberia and Panama accounting for four-fifths of this group. The increase in the share of the developing countries is largely accounted for by the rapid growth of the fleets of small Asian countries – the world's largest liner company is now Taiwanese.

As Zacher points out: 'In the case of the issue of qualifications of ships' officers and crew, there has always been a great deal of difficulty in getting international agreements, because crew costs are an important component of overall costs ... and because national training and testing programmes vary a great deal' (1996, p. 51). He goes on to argue, however, that while developing nations and flag-of-convenience states will refuse to accept regulations they regard as imposing excessive costs in order to retain a competitive advantage, the major maritime industrialised nations will not allow this competitive advantage to be taken too far. 'The basic strategy that they use to prevent non-acceptance of international conventions is to require that all vessels using their ports must meet convention requirements. If the major trading states enforce such a rule, virtually the whole world fleet has to comply' (1996, p. 55). No doubt, but the questions are, first, whether such enforcement is genuinely feasible, and, second, the impact of flag-of-convenience states on the stringency and comprehensiveness of conventions. There seems little doubt on the facts that flags of convenience have acted as a form of regulatory arbitrage, allowing those who wish to do so to avoid regulatory costs. Certainly maritime safety cannot be enhanced by ships with poorly-paid and -trained crews speaking several different languages and using ill-maintained equipment, plying increasingly congested international seaways.

Further, Ellen and Campbell maintain that flags of convenience play a disproportionate part in ships involved in maritime crime: documentary and insurance fraud, illegal cargo diversion and scuttling, for example (1981, pp. 2 and 61–8). Zacher accepts that crime-control is one of the weakest aspects of the international shipping regime, because it involves criminal jurisdiction, which states are reluctant to surrender, and which involves considerable variation in the way in which crimes are construed in different countries and in the penalties attached to them, besides issues surrounding decisions to investigate and prosecute. There is no international capacity for maritime crime-control beyond that which exists for other international crimes, which is to say the limited good offices of Interpol, international extradition arrangements, and mutual support and assistance agreements agreed through such organisations as the British Commonwealth and the European Union. In the former case, the existence of similar laws and legal systems as a legacy of empire is an advantage, and in the latter the sustained drive towards greater cooperation is gradually bearing fruit in increased collaboration in criminal matters, though the creation of a Europol agency to enshrine achievements has been subject to long and fraught negotiations in the 1990s.

As we have seen above, the rapid expansion in the world shipping fleet was accompanied by a shift in control from the major industrialised nations to rapidly developing nations and to flag-of-convenience states. Besides this minority of states, others were also developing and engaging in trade at much higher levels, many of them newly independent states as a result of decolonisation. Where in the past, colonial and major maritime powers had owned and operated the ships, enforced standards and regulation, developed commercial infrastructure in law and documentation, and supplied insurance, as well as exercising criminal jurisdiction in what are now independent third-world countries, by the 1970s this cohesive system was greatly fragmented and many states and entrepreneurs lacked experience and support. This provided an opportunity for maritime frauds of several kinds: the publications list of the International Maritime Bureau (IMB), set up by the International Chamber of Commerce to combat maritime crime in 1981, includes annual piracy reports, counterfeiting, Nigerian oil frauds, prime bank instrument frauds, the sale of non-existent Marlboro cigarettes, container crime, besides cargo diversions, scuttling and documentary and insurance frauds. The prime objective of the IMB, as a private body, is to provide collective self-help for shippers and shipowners by circulating information, offering training, and maintaining records and registers, being available to conduct detailed investigations, and overall alerting legitimate traders to the risks that they may be exposed to in international trade. Vulnerability is enormously increased by naivety, can be greatly reduced by taking standardised precautions, and cut further still by knowing which number to call in case of crisis.

The degree of brazenness of international abuses probably reached a peak in the 1980s, with a rapid rise in piracy attacks, particularly in the Far East – there were 252 such incidents recorded in 1997, 24 up on 1996, despite increased bilateral efforts and patrols by a number of states. It was the scuttling of the tanker *Salem* in 1980 off the coast of West Africa that was the catalyst to action on maritime fraud, however. The ship was insured for $24 million and the cargo of oil for $60 million. It later emerged that the oil had been secretly discharged in Durban, South Africa and was part of an elaborate series of frauds involving insurance, cargo diversion and scuttling (Ellen and Campbell 1982, pp. 52–60). The pursuit of the offenders was lengthy, inevitably multinational, and only partially successful, but the story did become news and served to highlight the need for the IMB. Such are the size of the sums that can be stolen in international maritime crime, and such is the growth and volume of trade that, given the ingenuity of criminals and the diversity of opportunities, repeated criminal acts are scarcely likely to be lacking. It is hence unrealistic to expect the IMB to be able to stamp out international maritime crime, particularly given that it has no policing powers. It has, however, addressed the problem with zeal and undoubtedly increased the capacity of many honest shippers to protect themselves, and made life more difficult for some criminals. The IMB has hence constituted a significant complement to the weakness of the main regulatory regime administered through the IMO.

As suggested above, the IMO's efforts and achievements in maritime safety have not been insubstantial, but in one respect they have been shown to have been seriously compromised by the competitive and profit-seeking drive of shippers. The introduction of roll-on–roll-off (ro–ro) ships for cars and lorries greatly increased their carrying capacity and transformed their loading and unloading procedures. Whereas traditional loading methods required a crane, lifting each vehicle into place, and Dover, for example, handled 10 000 cars a year in 1953, the introduction of ro–ros enabled this to exceed 100 000 in 1954. The figures rose to 2.5 million vehicles in 1985 and 4.5 million in 1994, by which time 4800 ro–ro ships were operating world-wide. These are of various types, two-thirds designed to carry freight only. The best-known are those carrying commercial vehicles, cars and their passengers on relatively short routes where ease of loading and unloading is of paramount importance in enabling journey-frequency to be increased and hence prices kept low and profitability secure (IMO 1997).

The fundamental weakness of ro–ro ships was obvious from the start: the ro–ro principle requires large, open vehicle decks, which will make the ship liable to very rapid capsize in the event of the hull being holed. In the absence of the water-tight transverse bulkheads characteristic of conventional ships, which enable them to be designed to resist sinking with a specified number of compartments flooded, the ro–ro is exceptionally vulnerable not only to the amount of water taken on but to the effect of even a limited amount collecting as the ship rolls, causing very rapid capsize. There are additional weaknesses. It is hard to provide really secure fittings to ensure that the variety of vehicles, including coaches and heavy goods vehicles, motor-cycles and caravans (towed and motorised) can be securely lashed down. Even if they are adequately secured, the cargo on goods vehicles may not be loaded and secured in such a way as to remain stable in the pitching and rolling encountered in a heavy sea.

Worse, the design of ro–ros gives them a low centre of gravity which has the effect of considerably increasing the speed with which they roll, so putting exceptional strain on lashings securing both vehicles and their loads. If a vehicle or its load breaks free at sea, the movement of the ship will cause it to cannon into other vehicles, not only causing progressive damage, but breaking them free and potentially allowing them to collect on one side of the ship and threaten its stability. A Norwegian study showed that 43 per cent of ro–ro losses could be attributed to cargo-shifts, and a French study found that half of the damage incurred on Channel and Mediterranean ro–ros was the result of insecure vehicles and cargo (IMO 1997, p. 9).

These are not the only problems. The large open-plan vehicle decks with many vehicle tanks full of fuel are a major fire-hazard. The cargo access doors, usually at the bow and stern, are obvious weak points because they are doors at points in a conventional ship that are strongly constructed so as to be capable of taking heavy weather and surviving minor collisions. They are likely to become weakened and distorted because they are often part of the ramps used for loading and unloading. Constant opening and closing of the doors can also over time cause distortion and compromise watertightness. The doors are usually located close to the water line, so that even relatively minor shifts in trim will lead to flooding if the door is open. The high sides of modern ro–ros make speedy evacuation difficult. Lifeboats are harder to launch the higher they are, and their height above the water will be greatly increased by a significant list. Given the speed with which ro–ros can capsize, this is a serious problem. The Norwegian study of ro–ros in 1983 showed that 60 per cent of ro–ros which were lost following a collision sank in less than 10 minutes. Yet the same study also showed that the total loss rate for ro–ros was less than half that for the world fleet (0.25 per cent over 13 years as opposed to 0.55 per cent: IMO 1997, p. 4).

The number of major losses involving serious loss of life has been relatively low. A Belfast rail ferry had her stern door stoved in by heavy seas in 1953 and 133 people died. At least 264 died when a Greek ferry foundered off Athens in 1966 when a vehicle broke loose and smashed open the loading hatch. The Norwegian study identified 36 sinkings between 1965 and 1982. The IMO and its members responded to the risks presented by ro–ro ferries up to the loss of *The Herald of Free Enterprise* in 1987 with the loss of 193, as a result of sailing with her bow-door open to save time, by engaging in extended technical debates which attempted to incorporate ro–ros into the same matrix of safety and stability calculations as conventional vessels. France raised the question of ro–ro safety in a comprehensive paper in 1976, and consideration was given to creating a special category of ships covering ro–ros which would need its own requirements. This was not accepted, and the issues continued to be discussed as a series of technical matters regarding securing of lashings, load-lines, free board levels and the rapid drainage capacity of car decks. The issue of lack of transverse bulkheads was part of these debates, which continued without resolution up to 1987.

The loss of *The Herald of Free Enterprise* led to massive publicity, a judicial enquiry which heavily criticised the owners, P&O, for slack management and procedures, and to an attempt to prosecute the company for corporate manslaughter. Britain asked for emergency changes to the latest SOLAS convention (1974), which were adopted rapidly and came into force in 1989. These included the requirement that indicators be provided on the bridge showing the loading doors to be open or closed, television surveillance to monitor water-leakage through the loading-doors, regular patrolling or television surveillance of car-decks during voyages to monitor insecure vehicles, and additional emergency lighting for passenger ro–ros. In 1989 further amendments were adopted requiring ro–ros built from 1992 to be equipped with power-operated sliding watertight doors which can be closed within one minute.

The principal risk introduced in 1953 was hence finally addressed, though it was expected to be some time before all ro–ros had watertight internal doors. The question then became the costs of installing such doors in existing vessels versus the risks of loss in the various types of ship. A scale was devised based on an elaborate calculation of risk, which would require all ships to be fitted with internal bulkheads by 2005. Other improvements were also introduced, for example the requirement in 1992 that new passenger-ships be fitted with fire-detection alarms centralised in a control station, which was to be continuously manned, and from which fire-control could be organised and implemented. Improved responses to emergencies and training for their implementation were also introduced.

In September 1994 the passenger ro–ro *Estonia* sank in heavy seas in the Baltic as a result of damage to her bow door, with the loss of over 800 lives. Most passengers were asleep and the ship sank rapidly, giving them no chance of escape. A number of further improvements were introduced, including requirements for passengers to be identified and counted, as are airline passengers and for unannounced annual inspections of ro–ro passenger ships to check that safety provisions are in order. An attempt was made to bring forward the phasing in of watertight doors and to require that ships be able to remain stable with up to half a metre of water on the car-deck. There were protests at the costs, calculated at £52.1 million for the UK fleet, besides loss of revenue as a result of reduced capacity and longer turnaround times. Agreement could not be reached, and in the end it was agreed that governments could conclude regional agreements affecting their own countries, a measure proposed by Denmark, France, Italy, Norway, Spain, Sweden and the UK. It will hence have taken half a century for ro–ros to be modified from disasters waiting to happen to a reasonably safe and efficient means of transport. The IMO's concluding comment is significant. 'Many of the measures adopted by IMO in the past have been designed to minimise the consequences of accidents. The emphasis now is on trying to prevent accidents happening at all' (IMO 1997, p. 93). This signalled a third major phase in attitudes towards shipping. The second was introduced with the advent of reliable, large and numerous steamships, superseding slower and more vulnerable sail, and involved accepting the need for increasingly comprehensive safety regulations. This third stage involves abandoning the idea of the sea as containing forces which will inevitably overwhelm shipping at times, and replacing it with the expectation that, given modern levels of understanding, ship design and technology, accidents need not happen and should not be allowed to. As the ro–ro story indicates, however, it is not only the sea that maritime safety has to contend with.

Drugs: the failure of regulation

Generalisations about all societies are traps for the unwary, but it seems safe to say that most if not all societies have used drugs of some sort. Often use of powerful drugs is restricted to religious, magical or mystic ceremonies or special occasions, as for example the use of various hallucinogenic drugs by many of the native peoples of North and South America. Different drugs have different effects: one might contemplate taking amphetamines before a major sporting contest, but alcohol only after it. They also vary in their potency as intoxicants: cannabis and tobacco are relatively mild where hallucinogens and opiates are powerful. Finally, while all drugs probably have some habituating effects, in the sense that users become reliant on access to their effects for release from life-stresses, they vary widely in their addictive effects, with the user suffering severe and occasionally fatal withdrawal symptoms in some cases, and far less physical symptoms in others, and in time taken for physical dependence to develop: 20 years or more with alcohol, a few weeks or less with crack cocaine.

All these features have contributed to the world-wide disaster that drug use has become in the twentieth century. It is important to remember that it is a distinctively modern phenomenon, which has its roots in the four factors of familiarity, supply, distribution and vulnerability in consumption. Since this chapter is concerned with international regulation, this section will focus principally upon supply, but the failure of sustained and quite substantial attempts to control supply cannot be explained entirely in isolation, not least because supply is not the most important of the four factors. The most important is familiarity, that is, the establishment of a drug within a society and its culture which structures and manages its use. This is not to say that management is always entirely successful: Britain, particularly England, manages alcohol far less well than other European countries, and excessive use has long been associated with violence, domestic and public, individual and collective. Opium, on the other hand, was in widespread use in Britain in the nineteenth century for both remedial and recreational purposes and had been available for a long time without causing serious problems. Even new and severely addictive drugs can be managed in time. Thus Massing (1998) argues that the decline in crime recently recorded in American cities is not to be accounted for by more robust policing, which has only been adopted in a few cities, notably New York. Crime rates have fallen also in cities which have retained traditional policing, the reason being, argues Massing, the passing of the crack epidemic as a younger generation becomes wise to the addictive and degrading consequences of experimenting with the drug and avoids it, and the number of users, with their powerful need to sustain their habit, declines.

The peculiarity of the twentieth century, especially in the industrialised countries, has been their exposure to a series of unfamiliar drugs, illegal such as ecstasy, legal such as barbiturates and tranquillisers, and both legal and illegal, such as opiates and amphetamines. This alerts us to the fact that the management of consciousness has been an increasingly substantial agenda for the pharmaceutical industry as well as for popular culture. Learning how to cope with an ever-changing succession of new drugs with differing effects and addictive properties has constituted a demand which few cultures can manage successfully. From this perspective we have done rather well. Successive generations of the young from the beginnings of the active experimentation with drugs in the 1960s have learned to manage and discriminate in their use of an ever-greater range of drugs with ever-greater confidence and success.

This does not mean that there have not been casualties. The toll in addiction, death, ruined health, destroyed families, death and disease from needle use, crime and corruption has been enormous. The point is that, despite constant forebodings, most of the population has not succumbed to these horrors, even among those who experiment, or even among the increasing numbers who use drugs regularly. Those who have succumbed have been vulnerable, either because uninformed, like the housewives who became addicted to minor tranquillisers widely prescribed in the 1950s and 1960s, or the middle-class Americans who became addicted to morphine and heroin in the early years of the century before the implementation of the 1914 Harrison Act made that illegal; or because their circumstances made them particularly vulnerable, like the GIs who took heroin, which was widely and cheaply available in Vietnam, or the urban poor and unemployed, who constitute the majority of the drug-addicted population of modern western societies. The vulnerable are at risk of being damaged or destroyed if they lack support, but if they do not, even addictive drugs can be beaten. Some GIs remained addicts when they returned from Vietnam but most did not; many housewives took years to defeat their very powerful addiction to minor tranquillisers, but most succeeded; middle-class Americans did not turn to illegal opiates supplies in large numbers when legal supply was cut off after 1918 (Duster 1970). The maintenance of a pool of poor, unemployed, powerless, under-educated and low-status people in the midst of affluent societies has sustained vulnerability. Drug distribution has been an illegal route to affluence, power and success for such people and distribution networks have been sustained by the capacity of drug money to corrupt politicians, police, judges and other public officials.

Attempts at the international control of drugs derived from a perception, dating from about the beginning of the century, of the dangers of the spread of new drugs coupled with an appreciation of the addictive capacity especially of the opiates. This perception was born out of the experience in the nineteenth century of the disastrous effects of opium on populations unused to it and vulnerable to addiction. The British fought two wars with China in the middle of the century before achieving the right to sell opium to China in order to balance their trade purchases of teas, silks, spices, porcelain and other commodities. Within a generation, opium addiction was widespread in the coastal region. The British recognised a similar problem in India and were equivocal as to its implications: on the one hand, opium rendered colonial populations passive and unlikely to cause trouble politically; on the other, addiction led to the neglect of families and of personal health. There was hence growing concern, particularly about opiates, in a number of countries, which was brought to a head by two further developments: the refinement of opium into morphine and then into heroin, and the capacity to administer this very effective painkiller by hypodermic injection, but at greatly increased risk of addiction; and the widespread use of morphine for pain relief in the First World War, greatly expanding knowledge and use of the synthesised opiates and creating a number of addicts, as well as a small pool of medical staff who became addicted because of their personal circumstances and their easy access to drugs.

The stage was set for both national and international reaction to the problem. The national reaction took two broad forms, typified by the American version, which was to outlaw opiate use entirely except in restricted medical circumstances and to criminalise addicts; and the British, which was to allow addicts to be cared for by doctors and prescribed maintenance doses to stabilise them until they could be weaned off their addiction. The American system provided the basis for a black market in drugs which required international supply, while the British one arguably contained the problem to a very limited number of addicts until circumstances began to change in the 1950s (Schur 1966). With the Eighteenth Amendment prohibiting alcohol, America created ideal conditions for the rapid development of organised crime syndicates to supply alcohol, which entrenched themselves and made large profits during the period until repeal in 1933. Though some had scruples about moving into drug supply, notably heroin, thereafter others did not, and that and the almost entirely illegal gambling industry provided a substantial basis for developing racketeering further.

The dangers of the spread of opiates in particular were thus widely recognised by the early years of the twentieth century and began to be reflected in a series of international agreements which attempted to limit supply to that which was needed for medical purposes. The first of these was the 13-nation Shanghai Conference in 1909, which became known as the Opium Commission and which gave rise to the International Opium Convention agreed at the Hague in 1913. The League of Nations, established after the First World War, set up a Central Narcotics Bureau in the second International Opium Convention of 1925, which licensed the trade in opiates. A further convention, aimed at limiting manufacture to medical needs, was agreed in 1931 and yet another in 1936 called for condign punishment of illicit traffickers by members of the League of Nations. The difficulty that international regulation faced was that opium-smoking was widely established in a number of countries, including India and China, and was very difficult to eradicate, despite agreements to do so during the interwar period. Besides this, opiates had important medical uses and hence could never be entirely outlawed, and states which tolerated opium-growing sanctioned. Further, opium poppies grow well in mountainous areas with poor soils, where they are an ideal cash crop: easy to cultivate, labour-intensive to collect and hence needing cheap labour, but the resultant raw opium is high-value, easy to transport and does not deteriorate quickly. Opium is hence perfectly suited to poor, remote, mountainous areas, which are also difficult to police. The value of the crop means that there is money to corrupt local enforcement. The existence of mountain ranges as borders in many countries reinforces the difficulties of enforcement since many of these areas are occupied by ethnic minorities resistant to the writ of the national government.

Even though control might in time become effective in major states, therefore, contested and inaccessible areas became a permanent reservoir of supply. One such area has been Afghanistan and the north-west frontier province of Pakistan, a region long contested by both Russia and Britain in the nineteenth century and never brought under control by either. The history of Afghanistan in recent years shows obvious similarities with this track-record in the light of attempts by Russia to exercise control after the British withdrew. The other principal area which emerged as a long-term source of supply was the Golden Triangle of the mountains bordering Myanmar (Burma), Thailand and Laos. This region was populated by ethnic minorities who had never been brought under control by the British or the French, and who remained independent after decolonisation. The situation was made more complex by the retreat into the area of elements of the Chinese Nationalist Army after their defeat by the communists in 1949. As Indo-China became engulfed in almost continuous war as the French were forced out and the Americans replaced them in a determination to prevent the fall of south-east Asian nations to communism after the Second World War, the position of the warlords and ethnic factions in the Golden Triangle remained ideal. They could play the various authorities off against each other, obtaining arms and acceptance of their position, and use the opium trade to finance themselves, corrupting everyone in the process. By the time the Vietnam war developed in full in the 1960s, the regime in the south was thoroughly corrupt and heavily involved in the opium trade, including supply to US troops, a situation naturally supported by the communist North Vietnamese because of its effects on military effectiveness. So heavily involved did the CIA become in attempting to manipulate factions to American advantage that it was at one stage supplying aircraft for the distribution of heroin from the Golden Triangle (McCoy 1972).

The Golden Triangle and the Golden Crescent (Pakistan and Afghanistan) have hence been sustained over the long term by their geography, and by the ambitions of the major powers which time and again fatally weakened attempts to exercise pressure on major sources of supply. In any case, eradicating illegal opium-growing is not just a matter of eliminating particular crops, but of providing an alternative livelihood for the growers. This can probably only be finally achieved by their integration into a successful lowland economy and polity, but in the medium term some form of crop-substitution is essential and this is very difficult to sustain: alternative crops grow less well and are worth less. Exactly the same problems beset attempts to control the production of cocaine in Latin America. The coca bushes grow well in the mountains of Bolivia and Peru, in areas far from central government control, and which have been subject to sustained guerrilla movements. It was to Bolivia that the Cuban revolutionary Che Guevara directed his attempts at exporting the Cuban success. He chose Bolivia because he believed it had the best conditions for the founding of a guerrilla movement of the sort that had been successful in Cuba. America has persistently seen the menace of communism as more serious than that of drugs or of brutal and authoritarian right-wing regimes in Latin America, and has used its resources disproportionately to support anti-communist regimes, which have only too often been willing to use drug money to enrich themselves. The outcome has been the establishment of vast drug-financed fiefdoms in Latin America and the corruption of the economies of several states to substantial dependence on cocaine for their prosperity, the so-called narco-economies. The US has been much more willing to spend on arming these regimes than it has been on containing the coca producers and offering them a stable, alternative way of life.

When President Nixon declared his war on drugs in 1970, it was then with a degree of hypocrisy, a strategy designed to curry electoral favour and to release funds to allow the development of new and more powerful drugs-control agencies with a national and international remit, answerable to the White House (Centre for Research on Criminal Justice 1975; Epstein 1977). Only in the case of Turkey did he have some success: he was able to exercise the degree of pressure necessary to get that country to suppress illegal opium-growing in the Anatolian plateau and achieve a measure of control over the illicit supply-routes through Turkey. Supply routes and international traffickers in any case change constantly as circumstances favour one country or another. Thus for most of the postwar period Italy has been a reliable supply route because of the extensive corruption of Italian politics and the increasingly powerful hold of the Mafia, especially in southern Italy and Sicily (Arlacchi 1986). With increasingly determined and successful attacks and mass trials of *mafiosi* in recent years and a degree of renewal in the Italian political system the place of Italy has been taken by the mafias of Russia, which have burgeoned in the power-vacuum and economic failure after the collapse of the Soviet Union and have been able to exploit their advantage and become major international drug distributors (Clutterbuck 1995, Chapter 17).

Although the UN took over the mandate of the League of Nations in respect of international drugs control, its efforts have for the most part been more symbolic than substantially effective. The world as a cooperative entity expressed through the UN has repeatedly declared its opposition to drugs and its wish to control them (UNDCP 1992). It has been constantly compromised by the overriding political agendas of its members, by the expanding markets for illegal drugs in the ever-richer industrialised world, and by the proliferating variety of synthetic as well as plant-derived drugs. Indeed, one of the UN's first acts was a new protocol in 1948 bringing synthetic drugs under the 1931 Convention. Agreements were rationalised and unified in 1961 in the Single Convention which codified earlier agreements, streamlined monitoring and control machinery, and banned the non-medical consumption of cannabis, opium and coca. It was strengthened in 1972 by a further agreement emphasising treatment and rehabilitation of drug users. A further convention outlawing psychotropic drugs was agreed in 1971, but this and the focus on synthetic drugs only created an additional problem of attempts to monitor and license the trade in the chemicals needed to produce synthetic drugs, the so-called precursors. As drug use became more and more extensive, President Reagan declared another war on drugs in the 1980s, far more extensively funded than Nixon's, and the UN again addressed the problem and agreed a control strategy. This involved a five-year action plan aiming at improved drug-control systems, a balance between legitimate supply and demand, eradication of illicit supply, a reduction of illicit trafficking, a reduction of illicit demand, and treatment of drug abusers (UNDCP 1992). The reports of the commission entrusted with implementing the plan showed constant growth in the numbers, sophistication and power of the suppliers and distributors, and a 1987 conference at the end of the plan adopted further measures to try to tighten control, followed by a further convention in 1988. Sixty states had adopted the convention by 1992. Although the UN Drugs Control Programme continues to offer aid and technical assistance in drugs control, crop-substitution and rehabilitation, combining the work of the International Narcotics Control Board, the UN Fund for Drug Abuse Control and the Division of Narcotic Drugs, it remains incapable of being more than a centre of information and expertise in the absence of sustained and serious input by the major world powers.

The only area in which there has been a significant development as a result of the expanding drugs trade is increasingly substantial efforts to control the finances of the traffic by attacking money-laundering. The initiative began in the US, with the recognition that the careers of major criminals could only be limited by separating them from their ill-gotten gains. This had historically been very difficult to achieve, since the more successful the criminals, the greater their skill in hiding their financial assets and in transforming some of them into legitimate activities. Techniques to launder cash by criminal syndicates had long been established and were pioneered by the American Mafia's most successful financial adviser, Meyer Lansky (Lacey 1991). The growth of the international drugs business and the continued power of the American Mafia in the 1970s led to a special statute to attack their finances, the Racketeer Influenced and Corrupt Practices Act (RICO). While the quite wide-ranging powers in this Act have proved very useful in pursuing criminal syndicates, the specific process of laundering funds was seen to require further legislation, which was introduced progressively. Initially the Bank Secrecy Act of 1970 required all financial institutions to verify the identity of those transferring $10 000 or more or receiving $5000 in cash, and to report all such transactions. Although this rule created an unmanageably vast volume of reports, the Act nonetheless also established a fundamental anti-laundering principle: know your customer. While this is not an insurmountable obstacle to criminals, it does breach the veil of secrecy which protects money-laundering. In due course the legislation was extended by two further acts in 1986 and 1988 which extended the remit of the law in this area to tax evasion and extended its jurisdiction beyond the US, notably where the offence is committed by a US citizen (Bosworth Davies and Saltmarsh 1994). Similar legislation was introduced progressively by Britain in the 1980s and 1990s, providing for the targeting and confiscation of drug money, the reporting of suspicious transactions, rather than those over a fixed threshold, with the onus on banks to recognise suspicious transactions and report to a specialised centre, the National Criminal Intelligence Service. The principles of breach of banking secrecy, of an obligation to report to the authorities, and to be sure of the identity of customers were hence established.

Most industrialised countries have passed similar legislation and many have set up similar institutions in response to the report of the Financial Action Task Force on money-laundering, set up in 1989 to address the problem. The UN had a role in the background to this, in the Vienna Convention of 1988, which for the first time highlighted money-laundering and obliged all signatory states to criminalise it and to take steps to seize drug traffickers' assets. The practical recommendations of the FATF were followed by a Council of Europe convention in 1990 which was designed to facilitate international cooperation on money-laundering control, and included non-European countries. Bank secrecy is agreed to be breached and cooperation on freezing accounts, investigation, execution of foreign enforcement orders and exchange of information are all provided for. The anti-money laundering campaign was implemented in the EU by a directive in 1993 which requires all member states to legislate to create the new regime, to establish the appropriate institutions for reporting and control, and to provide for international cooperation.

How effective has the anti-money-laundering regime been? Given that it has only been up and running for a few years it is impossible to offer a definitive judgement, but a number of points can be made both for and against it (Clarke 1995b; Levi 1994). A number of countries have created regulatory reporting centres to collate information from financial institutions, but many are overloaded, and the police and other enforcement authorities do not have the staff to investigate all cases, or to respond to reporting banks and let them know the value of their information. If this relationship is not sustained, reporting may rapidly become ignored or ritualistic, as it is alleged to have done in the United States where it was first introduced. Instances of enforcement action against banks and their staff, who are individually liable in Britain, for example, are few and far between, and it is arguable that police and prosecutors will be reluctant to take action against institutions for laxness, as opposed to active connivance. Nonetheless the additional flow of intelligence is useful in putting pressure on drug-traffickers and other serious criminals, and is a resource that can be developed in the future now that the significant step of breaching banking secrecy has been taken and banks are required to view their customers with caution as well as traditional respect. The implementation of the regime is unlikely to pose serious problems for launderers, who are quite capable of using dealings in property or art as a cover, or simply to hide behind a series of companies purporting to engage in legitimate business. As Savona argues, the new regime has stimulated a greater professionalisation by launderers, who now employ more accountants, lawyers and others to plan their financial operations carefully (Dorn *et al*. 1996, Chapter 12). And the larger operators will seek to exercise direct influence over banks by corrupting their senior staff, or by owning the bank.

Perhaps the most important result of the money-laundering initiative is that involves an explicit acknowledgement that serious criminals usually cannot be successfully pursued within one jurisdiction alone, and that information-sharing is hence vital. This reinforces the recognition that acceptance of a bank's verification of the status of a customer by one country has crucial implications for a bank in another where he transfers money. Launderers will obviously seek the weak links in the international chain and this in turn is gradually putting pressure on even offshore financial centres to improve the quality of their regulation and to reduce their commitments to absolute confidentiality with no questions asked. Genuine equality between nations, including those such as Switzerland with a powerful and long established culture of confidentiality, will take time but, as recent events such as complaints about that country's role as bankers to the Nazis have shown, determined pressure by powerful nations through the now highly interdependent world banking system can achieve change, albeit reluctant. While it is unlikely that substantial, integrated regulation of financial institutions will be achieved rapidly, it should be recognised that one source of the FATF initiative was the potentially destabilising effects of volatile illegal cash: drugs money alone has been estimated at $500 billion annually, besides the proceeds of other crimes and those of tax-evasion and corruption. It may be then that, even if drug-traffickers are not stopped, international financial regulation can take a few steps forward and at the same time financial institutions may take a more sceptical look at all their customers, and so be alert to fraud and other crimes and abuses committed by them, many of which, like laundering, are not self-disclosing.

Beyond the nation-state: association, federation and the European Union

A theme of this chapter has been the obstacles to effective international regulation that are frequently posed by the interests of individual nation-states, and behind this their jealous guarding of their sovereignty, making international regimes difficult to achieve, especially where legal codes, enforcement systems and constitutions are different. Many countries are, however, members of international agreements that bind them more or less closely to others, which it might be thought would assist in achieving regulatory integration, particularly since many such agreements are mainly or exclusively economic. Up to a point this is true: groups such as the Association of South East Asian

Nations (ASEAN) can be the basis for articulating common, and in this case regional interests beyond multinational trade agreements; the Commonwealth has been a quite successful forum for many third-world countries to articulate their common interests, with even countries without a British colonial past, from which the Commonwealth derives, now becoming members. It should not be forgotten, however, that nationalism remains a powerful force which is still creating new states: besides the disintegration of the Soviet Union, the Balkans have demonstrated that fissiparous character for which they were known in the early part of the century and even in Britain devolution and nationalism has gripped Scotland after nearly three hundred years of union.

To some extent this can be accommodated by federalism, which involves an explicit balancing of the rights of the region against those of the state, though as the example of Quebec illustrates, this may not always be seen as adequate. At least, however, in the case of federation the issues of national versus local regulation and of integrating policy are addressed through institutions, and there are well-established means for coping with the anomalies arising from 'states' rights' as they are referred to in the USA. As Majone (1994) reminds us, however, where an alliance is moving beyond a loose trade agreement but falls short of confederation, as in the European Union, all kinds of difficulties arise.

The weakness of the EU in respect of abuse of its principal funds administered through the Common Agricultural Policy has been referred to earlier (Chapter 6). A weakness in its implementation of the anti-money-laundering regime is a paradoxical consequence of its growing integration. Member states are required to implement the regime according to common standards, and it is presumed that all will do so; also the standing of a customer in one state is taken to be adequately established by a bank in another without further enquiry, yet a number of states are in reality quite divergent in their level of financial sophistication, with some of the poorer ones lacking the experience, money and staff to bring their financial institutions up to standard. On the other hand, as Majone points out, the very weakness of the EU as an entity in its own right and the limitations of its budget have made the issuing of regulations an attractive avenue for the pursuit of power, an avenue which can be travelled down the easier because of the substantial independence of the Commission. This body is in theory the EU Civil Service, but it is accountable not to the EU parliament but to the Council of Ministers, who represent member states, not an EU government, and hence often do not act in a concerted way to restrain it.

Nor is there any mechanism – a clearing house – for reviewing regulation and ensuring that it is collectively coherent, rational and enforceable, and there is only limited recourse to judicial review. As a consequence, there is a danger that the EU is becoming a regulatory juggernaut operating without restraint. Yet at the same time this very independence can give it the room to innovate where member states tend to be conservative, and to present a united front in international negotiations on matters of trade and regulation which carries more clout than that of member states. The complex and fraught progress of the EU will be severely tested by the launch of its common currency in 1999, which will sooner or later demonstrate the need for greater political integration, with the institutions to give it expression, as the essential counterpart to making greater economic integration work.

Informal and professional pressure for international standards: the case of pharmaceuticals

This chapter has emphasised the difficulties that lie in the way of international regulation, while accepting the increasing need and demand for it. Many of those difficulties have been shown to derive from the diverging interests of nation-states. It is appropriate then, to conclude with a perspective that not only is more optimistic, though cautiously so, and which sees informal pressure, professional self-esteem and the global spread of knowledge and awareness as significant elements in raising standards. Braithwaite's work on the pharmaceutical industry in the 1980s (1984) castigated it as the most crime-prone industry in the world. A decade later (1993) he finds some improvement in international standards, achieved largely through private and informal means.

Braithwaite argues that the interaction of professionalism, consumer pressures and the internationalisation of knowledge about drugs is shifting the perceptions of drug companies as to where their self-interest lies. Professionals working in the industry have common standards, and may of course be internationally mobile in their careers, as well as meeting regularly with their peers at international conferences. 'Most if not all … companies set much higher standards in the least regulated third world countries than they are required to meet by the laws of those countries … because it would simply be intolerable to the professional standards of the people who work for them to stoop to the levels allowed by lax laws' (1993, p. 21). Consumer pressure can reinforce this. Braithwaite cites the example of Ciba Geigy which was heavily criticised in the 1970s and 1980s for abuses, including covering up the disastrous side-effects of one of its products, and which took the initiative in the late 1980s to get other companies to be more open about the risks associated with their products through a voluntary reporting scheme. This attempt to create dialogue and openness has not had an overwhelming success, but it has attracted the support of some of the companies with the worst records in the past, keen to improve their standing. While this is partly no doubt cynical image-rebuilding, it also involves greater disclosure and a willingness to accept that unforeseen risks are a major problem that drug firms need to address publicly if they are to be trusted. This process is reinforced by active consumer bodies, who put specific questions to drug companies and can now expect real answers rather than public-relations blandness. One Australian-based group, the Medical Lobby for Appropriate Marketing, corresponds with doctors world-wide about the way in which pharmaceutical products are marketed and writes letters of complaint where this appears to be abusive. A strategy as simple as this is quite effective in reminding the drugs companies that medical opinion is international too. In 1988–90 ten out of 26 complaints led to a withdrawal of a product or modification of its marketing literature. Braithwaite argues that such consumer activism gives heart to honest professionals in the industry, who will be more likely to blow the whistle on abuses and to supply damning evidence discreetly to consumer lobbies. More widely Porter (1990) claims that industries achieve real competitive advantage not from evading minimum standards, but by deliberating exceeding them and so showing the way ahead and what can be achieved.

'Sophisticated buyers will usually appreciate safer, cleaner, quieter products before governments do. Firms with the skills to produce such products will have an important lever to enter foreign markets and can often accelerate the process by which foreign regulations are toughened' (1990, p. 649). This perspective takes us to the final chapter, on the future development of regulation.

8
The Future of Regulation

This book began with an analysis of the sources of regulation and of the rise of the regulatory society. The tendency of more and more areas of life, especially economic and business life, to be regulated was identified as characteristic, so pre-empting one obvious point about the future of regulation: it is likely to extend further. That prompts the question: surely it cannot go on extending forever? Would that not be a form of authoritarianism, if not totalitarianism? The only grounded answer one can give to such alarmism is that there are no signs of the process stopping yet, and recent history suggests quite the contrary. It is hard to think of an area of life in which, once regulation has been imposed, it has been abandoned. The vogue term of the 1980s, deregulation, which has been commented upon at several points in the earlier part of this book, was not in practice taken to mean a complete absence of regulation. Rather it referred to a combination of less stringent regulation, which in practice meant that it could be ignored, and a greater measure of self-regulation, which in practice was an invitation to the regulated to seek capture of the regulatory process. Deregulation failed as a political movement. Like the attempt to 'roll back the state' of which it was a part, it adopted a populist rhetoric of liberation from unnecessary restraint and cost, but rapidly came up against well-established popular expectations of security in all respects, with the state to act as the final guarantor. Deregulation also produced some spectacular disasters, notably in the financial sector.

New right regimes have been succeeded by social democratic ones in Europe and America. For them regulation poses quite different problems. Its advantage is that it is the successor to the welfare state, whose expansion can no longer be funded. Public security can be achieved in a plethora of detailed ways by regulation without huge cost to the state and hence the taxpayer, though there are quite bitter arguments, especially in America, about the cost of regulation and of value for money (Pildes and Sunstein 1995). The difficulties lie in maintaining effective and appropriate regulation, matters that have been a central concern of this book. It is not easy to achieve agreement among all parties on what degree of protection is needed and on what are the necessary means to achieve it. The regulated, and particularly business, are likely to resist, and the public and particularly consumer groups, to demand.

The problem for business lies in accepting that regulation will continue to extend, and that its formal autonomy will be compromised. Nor can an expressed willingness to embrace regulation be a cover for a determination to subvert it. Genuine engagement, and acceptance that other stakeholders have rights (even if not necessarily as extensive as they would like to claim) are essential to breaking out of the cycle of regulation by crisis and scandal, where business denies the problem for years, only for the reality of the problems and abuses to build up, with serious consequent damage to the industries involved. We saw this on a short cycle with the pensions mis-selling scandal in Britain and the Savings and Loan scandal in America. It has been serious in respect of asbestos, whose dangers were known by the 1930s, and whose costs contributed to the near-destruction of Lloyds insurance market in the 1990s. The same can be said of nuclear power, whose virtues were touted from the 1950s to the 1970s, when the evidence of leaks and contamination began to emerge; in the 1980s the key question was posed: what about decommissioning? Pesticides have progressed through the cycle twice with DDT, Aldrin and Dieldrin widely used from the 1940s to the 1960s, until the dangers of accumulation in fatty tissues and the collapse of the bird population led to their being banned (Carson 1965). They were succeeded by a new generation of pesticides, a number of them organophosphates, which are also used in the manufacture of nerve gases. Their dangers are now becoming recognised and they are being controlled in the light of chronic and acute damage to farm workers' nervous systems. Cars have been through a series of such cycles, beginning with safety from the 1940s to the 1960s, with resistance to it as an issue by manufacturers despite the benefits of air-bags and seat-belts and with roadworthiness being subordinated to comfort, elegance and image (Nader 1965). Further campaigns were waged over leaded petrol, said to be essential, and exhaust control emissions (catalytic converters) said to be grossly expensive, ineffective and unnecessary (Wilson 1983). Tobacco is perhaps the greatest example of all, with the international producers committed to the absolute rejection of the dangers and an absurd emphasis upon freedom to smoke, accompanied by a shrewd diversification into other fields and a shift from cigarette markets in the industrialised to the third world (Lemann 1998).

Will business learn, as Porter (1990) argues, that the best way to survive is to run ahead of the regulatory game rather than to resist doggedly and claim comprehensive virtue while more and more outside are identifying vices? As we saw in the last chapter, Braithwaite argues that parts of the pharmaceutical industry may have taken this step. Two examples suggest that others have not and the reasons are interesting. Braithwaite points to the distinctive features of pharmaceuticals in sustaining a world community of science-based researchers embedded in an ethical culture. This is not characteristic of other industries.

Heavy industry, responsible for air pollution, for example, may in some countries have been pushed down the road of ever-superior emission-control processes and equipment, but in the US, which has the greatest concentration, another tactic has been employed: trading of emissions quotas. The idea is that industry in a given region is set targets for the reduction of overall emissions and firms are given quotas based on the targets and on past output, but they are free to buy and sell their quotas. Thus if it is very expensive for them to invest in control equipment, but they are moving to a new plant in five years' time, it may pay a firm to buy extra emissions quotas from others who are achieving progress faster. Under the Clean Air Act 1990 sulphur dioxide emissions can be traded in this way in America. It has also been a tactic proposed by American representatives at climate summits addressing the problems of greenhouse gases, notably carbon dioxide. The idea is that tradable emissions quotas are a cheaper and more efficient way to achieve lower overall pollution than traditional command-and-inspection methods. Faced with an enthusiastic exposition of the merits of this system, the rest of the world demurred. It was not coincidence that it was America, the world's greatest contributor to greenhouse gases by far, which refused to commit itself to a programme of reductions unless poor third-world countries also did so. The formal economics underlying the tactic are apparently impeccable, so why did so many other countries smell a rat? In the first place, the opportunities for bargaining and cheating over the initial setting of quotas, which have a monetary value under the scheme is obvious. More importantly, control of regulation is handed back to those who are the source of the problem and the regulatory agencies retire to the sidelines and sit on their hands. In the meantime, free market ideology has been smuggled back in, and it is shown that the best way to achieve progress is to create a free market in pollution quotas. It is not just, as Pildes and Sunstein (1995, p. 66) point out, that there are expressive and symbolic aspects to regulation, that it stands for a public commitment to refuse to tolerate a problem, and of the taking of the powers necessary to address it. By handing the problem back to the industry it invites it to limit achievements to what the industry says it can do, and circumvents the issues of ascendancy and capture. The result is that emissions remain something to be managed and calculated, a technical matter, rather than the technical side being driven by a moral aspiration.

It may sound foolish to use the latter term in relation to business: after all is it not just about making money? A good many of the examples in this book suggest that business itself sees its task otherwise. The financial institutions responsible for so much damage, for example, widely cultivate an ethic of essential service to the public, especially on the retail side. This was precisely Braithwaite's point about the pharmaceutical industry, where it is self-evidently the justification for the industry's existence. There is a tension within business between the desire to provide a service and earn a reward, and the desire to stay in business and make a profit. If regulation is to succeed it must build on the service-oriented and ethical side of business, so that the drive for profit does not constantly prevail. Emissions quota-trading does precisely the opposite and is hence a pernicious form of regulation: it shows how there can be profit from pollution.

Another example illustrates a regulatory crisis in the making, an outcome of long-established, but in time anachronistic and perverse assumptions, that sustain very successful industries that will be hard to reform. Food in the industrialised world is ripe for regulatory crisis. Already there have been minor problems: scares over food additives in the 1970s, over the use of hormones and antibiotics in lifestock-rearing in the 1980s and 1990s, over the use of pesticides and their residues in animals and plants from the 1960s onwards. Recently there have been crises over BSE in cattle, food poisoning – salmonella in eggs, E-coli 0157 in meat, not to mention widespread increases in food poisoning through restaurants, fast food outlets and chilled meals – and genetically engineered plants and animals. Besides the panics associated with these problems, food-faddism has produced a minor new industry in supplements: vitamins, minerals, herbal goodies and other dietary supplements mid-way between food and medicine, which are turning eating into a neurosis for increasing numbers. That neurosis is explicit in the increasingly widespread eating-disorders anorexia and bulimia and beyond them the obsession in the western world with dieting. In part, this is the cultivation of the body beautiful and the fending-off of obesity, which is now rampant. In part also dietary fads are a means to securing health and now sustain a new kind of food, health food, and new shops to buy it in.

At the same time food is available in unprecedented quantities and unprecedently low prices (as a proportion of average incomes) and in unprecedented apparent variety, imported from all over the world, reflecting a dozen different cuisines, presented in an ever-developing variety of ways, unthinkable a generation ago. Thus in Britain where garlic was unobtainable outside specialist shops in the 1950s, the favourite dish today is chicken tikka. This reflects a great transformation and a great achievement. The transformation is from the rationing of the 1940s of a rather dull, unimaginative and standardised diet to the abundance and apparent diversity of today. The achievement is the triumph of modern industrialised agriculture, vastly expanded, more efficient and sophisticated food processing, adding freezing and chilling to its traditional armoury of drying and canning and dramatically improving distribution and handling as well as making advances in processing itself and in the marketing of the results – pot noodles and pasta sauces join baked beans. All this is now delivered through the supermarkets, which have come to dominate food sales, and which have over time achieved service, speed, hygiene, good presentation, sophisticated marketing and the availability of a vast range of product lines.

All this has not simply been the result of the efforts and ingenuity of farmers, food processors and retailers, however. The transformation has been driven by food policy, which has emphasised the need to feed the population and to produce quantity. Thus farmers have been cajoled, sold to and subsidised into producing in larger units, using intensive methods, and accepting the succession of techniques offered by the Ministry and by the agricultural chemicals and feeds industries. These have supplied pesticides, fungicides, herbicides, specialised crop strains with higher yields, specialised animal feeds, dietary supplements, hormones and antibiotics, and vast quantities of fertilisers. Ever-increasing productivity in yields have become the accepted norm. Land, plants and animals are constantly made to perform better. This abundance is then processed through the food industry: dried, chilled, frozen, freeze-dried, canned, cooked, turned into instant meals of bewildering variety, as well as more and more exotic snacks and other instant foods. With constant advertising and marketing this has produced at least two generations of children reared on breakfast cereals, confectionery, crisps and hamburgers who now find traditional food unpalatable, and whose lunchtime indulgence is the deep fried Mars bar. Since the shelf-lives and the potential profit of processed food are superior to those of fresh, and this convenience food has been shown to sell well, supermarkets have enthusiastically supported this trend. At the same time the customer has been taught to expect unblemished apples, perfectly round tomatoes and meat presented in a plastic package. The populations of industrialised countries are becoming habituated – more than accustomed and less than addicted – to bland, often processed foods with high carbohydrate and fat contents whose nutritional value is often dependent upon added vitamins and minerals. Quality of food, particularly in its raw form, is a matter that the customer is increasingly incapable of discriminating about.

So denatured has food become and so addictive in its processed forms, that some nutritionists speak of a 'food toxic environment'. So severe has the situation become that ordinary food unaffected by industrialised agriculture and unprocessed now has to be referred to by a special name, 'organic', which associates it with amateurism and eccentricity. Yet obesity, which is the outcome of over-indulgence in industrialised food, affects half of the American and one-third of the British population. The agricultural, chemicals, fertilisers and feeds, and food-processing and retailing industries that have grown rich on the basis of industrialised food are now immensely powerful and skilled in defending their products and practices. It is for this reason that the crises surrounding food have been limited. The success of the food industry in achieving ideological hegemony over the population is all but complete. The consequences of industrialised food will not, however, lessen but worsen, with the result that in the end minor regulation over additives, storage, hygiene, packaging and labelling will be inadequate and precipitate a major regulatory crisis, leading to a restructuring of the industry. This will be resisted doggedly and vociferously, because the alliance of industries will clearly be challenged and their long-term security put at risk. It is hence not always a matter of industry's benightedness that leads it to refuse to recognise the potential for regulatory change. In this case the food industry has grown, with strong state support since the Second World War, and has developed institutions which cannot adapt easily to producing real food.

If the acceptance by business of the need for regulation, and that regulation at times drives change is not likely to be easy, the same can also be said of the protagonists of regulation. In so far as they are represented by social democratic governments, a leading difficulty lies in their management of populations as to what to expect from regulation. The danger is that intervention is seen as the offering of a state guarantee, whether or not a regulatory regime is administered by the state, or by private interests, or by a mixture of both. Regulation regulates, that is, it moderates and brings matters to explicit attention that were neglected; it does not, in the majority of cases, eliminate the problem. In a minority of instances and at times, in response to public pressure, regulation may eliminate the problem by banning a substance or process and be able to enforce the ban effectively – recreational drugs are widely banned but available; nuclear power is banned in some countries and is not available.

One of the greatest difficulties that states have with regulation, therefore – and the same applies to businesses and industries subject to regulation – is achieving a balanced public understanding of what regulation can offer. This problem is exacerbated by the technical nature of much of the information available, and by the constantly changing diversity of threats. Thus, even if one were to become, not expert, but competent in handling technical knowledge in one area, say vehicle exhaust-emissions and their effects on one's household, one would stand to be nonplussed by another, say domestic radon, as the government publishes a map showing which areas of the country are at greatest risk, as the British government did in the latter 1990s. Nor will it do to say that radon has always been there, whereas car exhaust gases have not, since, as Pildes and Sunstein point out (op. cit.), when experts are asked to rate hazards comparatively, radon ranks quite highly.

As they go on to argue, this poses complex problems for the relationship between governments acting on behalf of populations, populations more or less confused, ignorant and vigilant, regulatory agencies responsible for achieving protection and progress, and regulated businesses and industries. It is not simply a matter of getting the public to be 'realistic' about what regulation can achieve, and to accept both that it needs to continue to act prudently and take reasonable precautions to avoid hazards (do packs of peanuts really need to be emblazoned 'contains nuts'?), and that there will always be low-level risks that are impossible to eliminate, to which one should not overreact. This is the problem of proportionality which we have discussed earlier. It is and will be hard to achieve and it will be difficult to control the tendency of sections of the public, which see themselves as particularly vulnerable, to panic at times, and to control demands for excessive, panic remedies. The public is also involved in regulation in quite other ways, however. It will tend to be sceptical of the bona fides of business, because business has often put profit before the public good and covered up abuses, and resisted remedy and compensation when they are exposed. It will be sceptical of governments, because they always seek to present themselves in a virtuous light and are unwilling to admit mistakes, omissions and failures. It will be sceptical of regulators as probably beholden to government or to the regulated industry, since it is to these two that they owe their existence. It is important in this connection to note that the public will often know little of the history of regulation and its achievements, which makes it very difficult for it to evaluate success and failures. Rivers in Britain, for example, are cleaner than they were 10, 20 or 30 years ago. That makes a pollution incident headline news that in the past would have been routine. It also raises questions of objectives. Regulatory agencies see their task in terms of reducing permitted sewage discharges and preventing accidental toxic discharges from industrial premises. The public see the return of fish and other wildlife. Boating is no longer so risky, swimming may be safe. What then is the public's long-term aspiration: that river water should be drinkable unfiltered? Anyone who has contemplated drinking from a hill-stream on a hot walk and then checked upstream and found a dead animal in the water recognises the folly of this, but how great a proportion of the public has this awareness?

One substantial task of governments, regulators and regulated industries is hence to educate the public in the progress that has been made to provide a realistic context for the risks that remain, which will also provide a better basis to convey the messages of prudence and proportionality. The public may also evaluate matters differently, however, as Pildes and Sunstein observe:

> For lay people the most salient contextual features include: 1) the catastrophic nature of the risk; 2) whether the risk is uncontrollable; 3) whether the risk involves irretrievable permanent losses; 4) the social conditions under which a particular risk is generated and managed – a point that connects to issues of consent, voluntariness and democratic control; 5) how equitably distributed the danger is and how concentrated on identifiable innocent and traditionally disadvantaged victims which ties to the notion of community and moral ideals; 6) how well understand the risk process in question is, a point that bears on the psychological disturbance produced by different risks; 7) whether the risk would be faced by future generations; and 8) how familiar the risk is. (1995, p. 57)

The public, in other words, provides a broad contextualised meaning to risks and adversities, which often goes beyond the framework within which regulation operates. It is nonetheless relevant and legitimate for that. As Pildes and Sunstein point out, on the one hand, regulatory debate tends to narrow around quantifiable risks and benefits, where less tangible factors may be significant. The outcome of formal cost–benefit analysis is frequently to the advantage of the regulated. On the basis of it, one study noted that, while hundreds of interventions by the Office for the Management of the Budget into regulation urged less stringency, only a handful urged more (ibid., p. 45). On the other hand, evidence that the realisation of some risks carries greater costs than those readily quantifiable can be seen in the Buffalo Creek syndrome. After the breach of a dam that killed 120 and made more than 4000 homeless, survivors were affected for years afterwards by loss of energy and direction and other disabling psychological changes as the result of the destruction of their community (ibid., pp. 61–2).

Public interest membership of regulatory agencies is becoming increasingly common. The public, through campaigns, because of electoral sensitivity, and with the active involvement of the media, for whom it is always a good story, have, as was argued in Chapter 1, been a driving force in regulation and its spread. A major task will hence now be to attempt its integration into regulation to get the public to move from the sidelines in demanding action and to come to centre-stage where it will also be, not merely more fully informed, but more jointly responsible for the outcomes. This will require careful thought and new institutions. It is one thing to take the modest step that has been taken so far, of allowing a very few and highly selected members of the public to become members of regulatory boards. This elitism sits happily alongside a continuing populism on the part of the mass of the population. The problem is to shift the rhetoric from 'we want something done about it' to 'what can we do about it?' The 'we' in the latter case are not confined to mobilising political pressure to get 'them' to act, but have the information (or access to it), and the responsibility to participate in acting to achieve remedy. Given this responsibility, the constraints will also be immediate. Many remedies have costs in terms of employment as well as direct cash costs. There are so many potential hazards now that no one has the time to take an interest in them all. This will force prioritising as long as action is dependent on public input. The public are not necessarily incompetent at such decision-making, even where it involves quite complex technical matters. Of course there has to be a balance between lay and expert input, mistaken views need to be corrected and technical matters properly and competently explained. On some issues, such as whether a suggested piece of equipment will perform adequately, it may be necessary to take expert advice on trust. The public is capable of participating in the final judgement in an informed manner, however, as the Oregon health-funding experiment demonstrated.

Oregon state recognised that health services were becoming covertly rationed and that the best treatment cannot be afforded for all medical conditions. It decided that it had no clear basis on which to ration funding and therefore created a commission to review the problem, with the requirement that it consult with the public extensively. The expert commission, having deliberated and formed its provisional views, consulted through public meetings and telephone surveys to identify quite precisely how people evaluated health-care priorities. As a result, it was able to construct 17 categories of health care in priority, ranging from preventing death with full recovery through non-fatal chronic conditions that improved quality of life if treated once (ranked eleventh). It was then able to identify specific treatments, their outcomes, and the ranked conditions, and put the results to the legislature, who voted to fund those most likely to provide benefits and to be cost effective (Pildes and Sunstein, pp. 93–4). The process was not a definitive success, but it worked in mobilising considerable public support, and more importantly in engaging the public in the debate and so making the priorities something that they were responsible for, rather than something that was demanded, or that was done to them by a paternalistic state.

Public involvement in regulation is a route that we are only beginning to go down. The arguments put forward here are to the effect that it is inescapable. Much imaginative work will need to be done if it is to be successful, for the opportunities for ego-trips, deceit, confusion, rancour and elitism are manifold. If a measure of success can be achieved, however, it should serve to take some of the pressure off business, for it should contribute to ending shrill demands for comprehensively effective action and substitute more informed debate. It should also stimulate greater awareness of relative priorities: how does the risk of disease from marketing unpasteurised but labelled milk compare with the risk of buying the wrong pension, or the risk of working in a high-street shop given current vehicle exhaust emissions, for example? Perhaps this is a way of saying that in a great variety of ways regulation will become a part (and it should not become too big a part) of the lives of all of us.

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