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The Regulatory State in Crisis: a public administration moment?

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The Regulatory State in Crisis: a public administration moment?

Abstract

The financial crisis has raised considerable challenges for the practice and study of Regulation. Public Administration scholarship is well-placed to make a serious contribution to the emerging debates regarding the future of Regulation. This paper points to two key challenges. First it asks whether the financial crisis does represent a far-reaching and systemic crisis for the practice and study of Regulation more widely. Second, it discusses what the ingredients of a high quality regulation agenda post-crisis might be. This paper suggests that the debate about Regulation needs to become more critical and open to 'unhelpful' challenges. Finally, it concludes by suggesting that debates regarding future regulation are not merely about structural rearrangements, but these debates' consequences affect the future viability of states and nations.

The Regulatory State in Crisis: a public administration moment?

It is difficult to disagree with the statement that the regulatory state is in crisis. The near universal policy trend - a combination of a reliance on quasi-autonomous regulatory agencies, private providers of public services, and contractual or at least formalised relationships between different parties involved in the provision of public services (Majone 1997) - has experienced a dramatic meltdown since 2008 at the latest. After massive bailouts of financial institutions, the accumulation of enormous public debts, and central bank initiated 'quantitative easing' exercises, attention has increasingly shifted to the architecture of financial regulation, both nationally and internationally. However, it is not just in finance where regulatory approaches have come under attack: witness the failings of the Kyoto instruments to offer a meaningful (painful) contribution towards mitigating climate change. Instead, national debates are characterised by exemptions, limited compliance and industry lobbying. Similarly, the area of food safety regulation has come under attack: with the case of salmonella-contaminated peanuts allowing President Obama to launch a wide-ranging review of food inspection regimes in the United States - with the legislative reform proposals (bill: H.R. 2749) to enhance the Food and Drug Administration's powers passing the US House in late July 2009.¹

The hallmarks of this crisis of the regulatory state represent a challenge to the assumptions that had become dominant over the past two decades or so. These assumptions were characterised by three key aspects. One, a view that traditional 'command and control' (i.e. official standards backed by legal sanctions) was unlikely to achieve desirable outcomes and that therefore alternative modes of regulation, in particular incentive-based regulation and 'enforced self-regulation' would provide for more desirable results. Two, a view that regulated organisations were able and willing to regulate and risk manage themselves, given an overall assumption of 'efficient markets. And, that customers would be able to choose wisely, given sufficient information. Three, and finally, a view that specialised regulatory agencies would offer a 'depoliticised' way out of highly political decisions.

¹ The opposition to this initiative suggested that the bill's proposals were potentially harmful to small and organic farmers because of their reporting and charging requirements and that certain farmer groups (livestock and grain) should be excluded from the scope of the Bill - indicating a further turf battle over jurisdiction between the US Department of Agriculture and the FDA ([Wall Street Journal](#), 28 July 2009).

All three of these assumptions have been severely tested over the past two years - if not earlier. Supposedly 'autonomous' regulatory agencies have been accused of being asleep at the wheel, being exposed to hyper-politicisation, and being used as political tools of blame-shifting (Baldwin and Black 2008). Regulated organisations have been shown to be incapable or unwilling to regulate themselves and manage risk with a view towards wider systematic risks. Individual consumers have not just been tricked into high-risk investment, but also faced substantial losses given international banking interdependencies and foreign bank ownership. Finally, 'modern tools' of regulation, such as emission trading, 'risk-based regulation' and a reliance on 'tit for tat' enforcement pyramids (Braithwaite and Ayres 1992, Baldwin 2008) have witnessed limited applicability and open hostility. A report by the financial regulator on its failings in the UK (the so-called Turner Review) noted the era following the nationalisation of most of the British banking sector required 'a different philosophy of regulation' (FSA 2009: 88). The review by the US Department of the Treasury was similarly damning of regulatory gaps between different institutions (US Treasury 2009). Regulators in Brazil, for example, despair at the thought of relying on tit-for-tat enforcement strategies in view of the adversarial and disinterested approach of large industries towards engaging in such a 'conversation'. Industries reject any engagement, knowing that the legal process of formal enforcement stages is stacked in their favour and that political favours can be called in at any time.

So what are we to make of this? In a recent symposium in Public Administration Review, Anne Khademian (2009) announced a 'public administration moment' in terms of putting forward an agenda for financial regulatory reform. This paper shares the sentiment that scholars interested in executive government, public administration and public policy have something to contribute towards debates on regulation. At the same time, her contribution as well as the overall symposium include in PAR was focused on US- and financial regulation. As the previous paragraphs have highlighted, the questions raised by the meltdown of financial institutions and the failure of high-intelligence instruments call for a wider discussion that draws on international and cross-sectoral debates and on the far-reaching and interdisciplinary literature in the field of Regulation. This paper seeks to contribute to this larger exchange. It does so by addressing two questions that are at the heart of contemporary debates. First, what is the nature of the crisis that 'regulation' as a field of practice and study is witnessing? Second, what can be the ingredients of a post-crisis regulatory approach,

especially when it comes to those aspects widely regarded as central to a 'high quality regulation' (HQR) agenda?

'Crisis, What crisis?'²

As noted at the outset, the failings and limited problem-solving capacity of contemporary regulatory arrangements across financial, food and environmental regulation seems indisputable. More widely, the rationalising tendencies of the regulatory state, namely the widespread application of cost-benefit or regulatory impact assessment tools, have also come under pressure - if only by the need for politicians to put together 'quick fix' rescue packages that are now sold as 'new industrialism'. One such example is the widespread attraction across national governments to support car production through 'cash for clunkers (bangers)' programmes. In the UK, the much-praised relabelling of the 'Department of Trade and Industry' into a 'Department for Business and Regulatory Reform' (emphasis added) in 2008 was quickly forgotten after another government reshuffle in 2009 led to its renaming into the 'Department for Business, Innovation and Skills' (at considerable cost for the taxpayer). Another sign of reduced attraction was the earlier shelving of, the Department's much-hailed announcement introducing 'regulatory budgets' in the light of sustained resistance and competing priorities.

At the same time, it is arguably the time for 'regulation'. Everyone wants 'more regulation' or 'regulatory reform' and the various attempts to change financial regulation over the early months of 2009 are witness to that. In the US, the review of financial regulatory arrangements did not provide for a radical reorganisation. The self-announced 'new foundation' was largely an institutional rearrangement to provide for cross-cutting harmonisation (a 'Financial Services Oversight Panel'), strengthened powers for the Federal Reserve, the creation of two new bodies (the 'Consumer Financial Protection Agency' and the 'National Bank Supervisor'), and the announcement of the 'death' of one regulatory body (the 'Office of Thrift Supervision'). In the UK, too, the tripartite oversight structure for financial regulation, a responsibility shared between the Treasury (Finance ministry), the Bank of England and the Financial Services Authority (created in 2000), has come under the spotlight. The Labour government announced enhanced powers for the Bank of England without altering the structure, while the Conservative opposition advocated the outright

² Sun headline, 11 January 1979, summarising a statement by then prime minister James Callaghan during the 'winter of discontent'. The actual statement was 'I don't think other people in the world would share the view there is mounting chaos' (see Oxford Dictionary of Political Quotations, 2007, p. 272, 5).

abolition of the Financial Services Authority. These proposals were condemned by a House of Commons Select Committee as mostly 'cosmetic' (Financial Times, 31 July 2009, p. 2 (London edition)). Similarly, in Germany, there have been some calls for the abolition of the recently established financial regulator (Bundesanstalt für Finanzdienstleistungsaufsicht) and its folding into the jurisdiction of the Bundesbank. Additional debates focus more on the scope and nature of regulatory instruments. These debates focus on aspects such as additional oversight or prohibition of particular market activities (e.g. short selling and 'flash' orders), the control of rating agencies, enforcement styles, or the creation of rules or principles to guide financial market reward systems. At the European and international level, debates about an 'international architecture' of financial regulation - whether in the context of the European Union or replacing regimes such as Basel II - have largely centred on national political preferences and vote-catching strategies, especially with regard to hedge-funds, and attempts to promote national financial centres.

In terms of activity and interest, regulation therefore does not seem to be in crisis. Indeed, students of public administration can contribute by pointing to highly relevant, long-standing debates within the literature regarding institutional design. Such debates relate to appropriate levels of government conducting oversight, the concern with trade-offs between specialisation and co-ordination across shared regulatory responsibilities, the advantages and disadvantages of different modes of control, or to the appropriate level of risk that we expect individuals to be able to accept. But underlying those debates are three more far-reaching questions that allow us to talk about a crisis in regulation. One question is whether or not there is an understanding of what regulation is for. A second question is whether or not we are talking about a crisis with contagious effects. And the third question is whether or not the current events are a 'rude surprise' to students of regulation. The rest of this section considers these questions in turn - and points to the contribution that public administration can make.

First, with regard to different understandings of what regulation is about, at least four different views can be distinguished. In one corner are those that regard the demand for 'more regulation' as a call for more sustained and heavy-handed oversight. Thickened procedures, closed loopholes and, possibly, an international architecture are supposed to contribute to enhanced regulatory quality, thereby creating more rule-bound distance from regulated industries. In a second corner are those that see 'more regulation' largely as an issue of professionalising the industry of regulators. That is, the key problem is seen as a 'too close' relationship to the regulated industries (generated to some extent to the well-known

'revolving door' patterns that have been common in the US and increasingly also in British regulated industries), while the relationship to other regulators has been too distant. In other words, what 'more regulation' is about, according to this view, is the promotion of a regulatory profession with a shared language (and rules of engagement, see Barzelay 2001) and the ability to learn across domains (Black 2002). In the third corner are those that regard 'more regulation' with considerable scepticism, although they would acknowledge that regulation is necessary to reduce market failures - but needs to be weighted against potential 'government failure'. In other words, 'more regulation' becomes an exercise of limiting regulatory intervention to reducing perverse incentives and blatant failings, such as, for example, the size of financial institutions that make them 'too big to fail'. In the fourth (and final) corner are those that similarly view regulation with considerable scepticism, mainly because of the inherent counter-learning, creative compliance and evasion by those regulated. 'More regulation' in the context of this 'cat and mouse' regulatory game is, as signed-up members to this view would argue, at best achieved through elements of surprise and 'contrived randomness' (Hood 1998), but ultimately risks creating even more 'dangerous' activities in the shadow of formal oversight.

All these four views of Regulation exist - and no compromise is possible across all four. None of them can claim intellectual superiority over the other, instead it shows that there is scope for continuous disagreement, dissatisfaction and challenge. In other words, if we can't agree on what more regulation is about and if we also are unable to diagnose a dominant or hegemonic view, then we are surely in a state of crisis. But, on a different level, it can be argued that such contestation is not just part of everyday life, but that for any reform to be successful it needs to appeal to different constituencies (Coyle and Wildavsky 1987). Accordingly, regulatory reform will, by necessity, require compromise - which in itself sows the seeds for future crises given inbuilt tensions. However, this is exactly where the 'public administration moment' is able to contribute: to emphasise the importance of hybridity and the need to incorporate potentially contradictory objectives in any regulatory regime (see Verweij et al 2006).

Turning to the second question, does the meltdown of financial institutions and the revealed failings of the contemporary regulatory state amount to an overall crisis or contagious disease? Or are we talking here about limited, self-contained outbreaks? One aspect is whether the financial collapse has reduced the appetite of the private sector to contribute to public services, for example, in critical infrastructures, such as energy, hospitals or transport

networks. Even before the financial crisis the ability of the state to transfer risk to the private sector or to rely on the private sector to provide for long-term investment decisions that went beyond asset-sweating had become an increasing concern, especially in the area of utility regulation (see Helm 2005).

Focusing on regulatory approaches themselves, the failings in financial regulation have highlighted three key areas in which the 'orthodoxy' of the early 21st century has been shown wanting. One is belief in the capability and interest of organisations to regulate and risk manage themselves. The idea of relying on organisational self-regulation that would be checked by regulatory oversight became popular, because of the inherent limitations of so-called 'command and control' or prescriptive rules (Braithwaite 2002, Coglianese and Lazar 2003). Indeed, when looking across to the area of food inspection, it is indisputable that old-style 'sniff and poke' inspections coupled with ongoing presence in slaughterhouses or processing plants was not a recipe for ensuring the absence of failure. Similarly, it is questionable whether invasive 'on site' inspections of financial institutions are likely to provide for better overall stability. So in other words, what is required is a more reflective and critical view as to the capabilities and motivations of regulated parties. Such a perspective has been a traditional part of implementation and enforcement research activities (see Hood 1976, Bevan and Hood 2006, LeGrand 2003).

A second area in which a cross-sectoral failure can be diagnosed is the functioning of ideas such as 'risk-based regulation' (Black 2005). Risk-based regulation is about the systematic focusing of enforcement activities according to probability and impact of a particular risk occurring. This 'philosophy' was widely said to have contributed to the collapse of the UK-based Northern Rock building society in 2007, when the Financial Service Authority was accused of having failed to spot the mounting risks. It also failed to appreciate the 'non-rational' behaviour among concerned savers that launched a run on the bank regardless of appeals by government ministers and bankers. But what this particular episode as well as the subsequent collapse of a further building society, the controversial forced take-over of HBOS by Lloyds-TSB and the nationalisation of the Royal Bank of Scotland showed was that risk-based regulation required decisive action when a potential crisis was detected. However, when there is no political interest in such decisive action, when high ranking politicians and public servants warn against publicity that could trigger a self-fulfilling prophecy in terms of undermining 'market confidence', and where different institutions haggle over responsibilities and shift around blame, then these tools are bound to fail. Nevertheless, there

has, as yet, been only a limited debate regarding the regulatory issues that cut across different industries. For example, risk-based regulation was previously advertised as 'modern' enforcement style and prescribed across UK-based inspectorates (see Hampton 2005). At the time of writing, there is little to suggest that the crisis of risk-based regulation has spread from finance to other domains.

Finally, is regulation in crisis because students of regulation have to throw their standard textbooks away and are faced with the equivalent of Soviet Block-Communism watchers in the late 1980s and early 1990s? Some criticisms can be voiced; for example, that regulation watchers have been too keen to embrace the search for 'alternatives to regulation' (such as market-based solutions) and 'light touch regulation' rather than critically examining these tools' pre-requisites (Gunningham and Grabosky 1998). Equally, one might criticise the personal/social - even consultancy-based closeness of those academically interested in regulation with the worlds of regulation in practice, both on the industry and the regulatory agency side. But looking more broadly at the regulation literature, it is difficult to suggest that the events of 2007/8 cannot be explained in terms of existing approaches towards regulation. For example, the capture approach that suggests that regulation will always be in the interest of the regulated industry (for different variants, see Stigler 1971, Peltzman 1976, Bernstein 1955). It is tempting to hypothesise that the failings of regulation in finance in particular as well as the very limited regulatory responses that have so far been initiated in both the US and the UK have something to do with 'capture'. Elsewhere 'capture' is still extremely relevant - for example, in the area of local enforcement with local inspectors often regarded as being prone to 'influence'. Similarly those that predict that reforms will always be moderated or filtered by institutions (for different variants of such an argument, see Laughlin 1991, Clay and Schaffer 1984, Hall 1972, Teubner 1987) are able to point to reform proposals and suggest that these are hardly 'radical' but follow established lines - with debate focusing on structure rather than on the more problematic aspects of enforcement practice and low 'relational distance' (the social proximity of regulators and regulatees) (Black 1976).

While the literature has not been able to identify the exact timing of the current malaise, it nevertheless pointed to the sources of the diagnosed failings. For example, Michael Moran (2003) in an argument that concentrated on the UK, highlighted how the attempt at depoliticised, formalised synoptic control, that was inherent in regulation, clashed with the political need for informal control and intervention. This unholy alliance, he predicted, would inevitably lead to hyper-politicisation rather than depoliticisation and to crises rather

than stability. Similarly, Michael Power (1997 and 2006) noted that ideas such as audit and risk management provided for 'programmatically' appeal that signalled some form of methodology of control and verification, but given their actual arbitrary nature and side-effects were as likely to cause destabilisation and crises. In other words, scholarship on regulation has not been completely asleep at the wheel and has pointed to likely sources of crises. In other words, the field of regulation-interested scholarship is in a good position to provide for a useful contribution to regulatory reform debates.

In sum, regulation as field of practice devised or exercised by government agencies is certainly in crisis. Dominant interpretations have been challenged. As yet, however, there has been very little appreciation of the lessons that can be read-across the failings in different regulatory domains. So far, therefore, we are talking about crises that remained 'within' policy domains. However, in terms of a field of study, regulation certainly may be challenged, but has not witnessed the sort of 'failure of comprehension' that would mean that the failure of regulation has been an unexplainable or unpredicted surprise. If this argument applies to regulation of individual policy sectors, how does it apply to those aspects of Regulation that relate to cross-sectoral agendas and instruments, namely the attempts to provide for instruments to promote 'high quality regulation' (HQR)?

Is 'high quality regulation' in crisis?

One of the key activities among international organisations (such as the OECD) and consultancies has been the propagation of particular cross-cutting techniques that supposedly improve decision-making among government departments and regulatory agencies alike (Hahn and Tetlock 2008). This agenda, widely labeled as 'high quality regulation' (HQR), has been associated with tools such as 'cost benefit analysis', 'regulatory impact analysis', 'risk based regulation' and 'principles of good regulation'. In addition, they are also associated with considerable staffing implications, with the US and the UK leading the way in terms of employing sitting armies of regulation watchers within government.

While the actual implementation of the HQR tools has at best been varied, there is little to suggest that they remain at the heart of government agendas.³ Concern with the cost of

³ Despite the high profile announcement of a revised Executive Order on Federal regulatory review under a 100-day timeline, the outcome of this exercise remained, at the time of writing, unclear (http://www.reginfo.gov/public/jsp/EO/fedRegReview/POTUS_Memo_on_Regulatory_Review.pdf, last accessed 18 August 2009).

regulation has slipped down the agenda internationally, given governments' forced choices in coming to the rescue of industries and labelling these 'new industrialism'. In addition, the urgency in which banks and other industry support programmes were set up also suggests that there was very little time to consider the procedural requirements that are at the heart of 'high quality regulation'. There are further implications of the financial crisis for HQR. In particular, the responses have led to an increasingly critical assessment of those international benchmarking exercises that were previously used to justify the adoption of particular instruments. Seeing instruments such as 'risk-based regulation' fail in those countries that were at the forefront of preaching the gospel of HQR has increased reluctance to engage in international learning exercises. In the light of the far-reaching issues affecting modern states in the developed and lesser developed world, the instruments of HQR appear at best marginal and faddish and being promoted by a small band of enthusiasts with little connection to the core problems facing states.

However, this may also be exactly the time for a more serious attempt at high quality regulation. Assessing the administrative and compliance cost implications of regulation are arguably more relevant than ever in the face of mounting public debt burdens. More importantly, the events of late 2008 and early 2009 with their near-daily announcements of new rescue packages across G8-countries also point to the need to incorporate procedural 'reflection loops' into decision-making. While often politically inconvenient, the need to consider different options and to consider these in a potentially transparent way through instruments such as 'regulatory impact assessments' offers means to add additional intelligence to decision-making (whether this is by information or consultation requirements or the need to assess the viability of different options). For some, linking intelligence and political/regulatory decision-making may in itself be an oxymoron, but only through more conscious efforts at devising ways of reflection within government will it be possible to reduce perversity and failure. This lack of critical questioning was at the heart of the failings of financial regulation. And as the contagion effects of the banking crisis have shown in terms of the national diversity of regulatory reform plans, cutting off international exchange and benchmarking activities is also unlikely to advance the quality of domestic regulation. It is also unlikely to contribute to cross-national understanding and learning. In other words, what is required is a more reflective and in-depth exchange about regulatory issues - beyond the fads and fashions of particular instruments and institutional arrangements.

For a post-crisis high quality regulation agenda to contribute to policy-making, at the domestic and the international level, requires therefore a move away from regarding regulation as an econocratic and technocratic activity towards an understanding of regulation that emphasises self-reflection and information-rich exchange and regards regulation as a constant source of contestation and trade-offs. HQR is therefore not about providing a solution to end political conflict about regulation, it is about enriching processes with information and about empowering some actors rather than others through procedural requirements. In sum, for procedural regulatory devices to make a meaningful contribution to regulatory and political decision-making and therefore to be truly 'high quality regulation', the national and international debate needs to move beyond the importing of templates as part of window-dressing activities to signal modernity, but rather to an open debate regarding trade-offs, competing approaches and contesting rationalities. It is only when the practice and study of regulation openly endorses contestation of regulation, then it will be possible to make a meaningful contribution towards 'high quality regulation'.

Public Administration, Regulation and the Naked State

This paper has used at its starting point the financial crisis and the subsequent questioning of regulatory approaches to enquire whether the field of regulation is in crisis. These are certainly challenging times for the orthodoxies of regulation scholarship. On the one hand, we have learnt that hierarchy, 'command and control' and punitive enforcement do not work. On the other hand, we have come to appreciate that relying on private organisations to regulate themselves and for regulators to meaningfully control organisational self-regulation is also no straightforward recipe for success. The quest is therefore to come to more complex understandings of boundaries of private and public regulation and of different modes of regulating that go beyond conversations about 'nudging' (as made popular by Sunstein and Thaler 2008). Most importantly, the 'public administration movement' is to encourage more open conversations about potential limitations and side-effects, within and across policy domains. Despite their enthusiastic endorsement, national governments have so far shown little action when it comes to 'whole of government' approaches to regulatory reform. If there is one further contribution public administration can make, then it is in providing for 'reliability checks' of regulatory regimes through empirical and theoretical work. However, this requires that administrations need to be willing to listen - and, arguably, this willingness to listen to 'unhelpful' messages has not been forthcoming in the past. In other words, to enhance regulation requires an adjusted relationship between the fields of study and practice.

This paper, however, concludes on a wider point. The regulatory state - a state that relies largely on authority rather than its 'organisational' or its redistributive-financial resources to achieve policy outcomes - was widely regarded as an example of the 'hollow state' in which activities were increasingly conducted outside the 'state' but controlled through the 'muscle' of regulation. The events of 2008 have most certainly brought the 'state back in', whether it is in terms of ownership or in terms of financial intervention in industries. As such, we have witnessed the return of what one might call the strong state. But one critical question is whether this is really the (re-)emergence of the strong state or whether the attempt to avoid financial and economic melt-down has led to a depletion of the resources of the power of the state. Considering demographic time-bombs and the challenge of climate change the prospect of a resource-depleted, highly debt-laden and inward-looking state points more to an age of the naked state than an age of a strong state. Imaging a naked state is not particularly attractive, but if this prospect of a naked state is indeed correct, then the contribution of public administration, regulation and public policy scholars reaches beyond informing debates about institutional architectures of regulatory bodies in an age of 'non self-correcting markets', it goes to the heart of the future of states and the well-being of their populations.

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