

THE PROS AND CONS OF GOVERNMENT REGULATION

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ABSTRACT

Regulation of human behaviour and human social interaction is a universal feature of both traditional and modern societies. In the latter, on account of their complex structure, regulation inevitably takes place at different levels, albeit within a framework set by government. Consequently, these societies are characterised by a web of formal as well as informal regulation and self-regulation, in other words by a plurality of regulatory systems. And this plurality of regulatory systems is an important source of tensions and conflicts in society.

RULES AND COMMANDS

Societies have to regulate human behaviour and human social interaction in order to maintain a system of ordered relationships, allowing maximisation of the probability of survival and the attainment of their material and non-material objectives. In brief, they need regulation if they want to avoid disorder and disintegration and to survive and prosper.

Regulation is a process consisting of the making, application, and adjudication of rules governing human behaviour and human social interaction. A rule is a norm which prescribes or proscribes what a specified category of social actors should or should not do on all occasions of a specified kind or on all occasions without qualification.¹ Since prescriptions

and proscription are expected to be observed, the only alternative the addressees have is to break them.

Rules must be distinguished from commands. In contrast to a rule which is a norm applying to a general type of situation, a command is not a norm in this sense. It is an authoritative order addressed to a particular social actor or a particular group of social actors, defining what the addressee(s) should or should not do on a particular occasion.

To be effective, both rules and commands must be enforceable. Consequently, if it were evident *a priori* that in practice a particular rule or command would be neither observable nor enforceable, it would be politic to refrain from making or applying that rule or from giving that command.

LEVELS OF REGULATION

Although the survival and prosperity of modern societies require government regulation, regulation is not exclusively by government. Formal and/or informal regulation takes place in various spatial social systems (such as subnational units, localities, neighbourhoods, and households) as well as in various functional social systems (such as formal organisations, informal groups, and families). Hence, different levels of regulation and self-regulation are to be found in modern societies, which means that the state is not a monopoly rule-maker and rule-enforcer.²

The individual therefore tends to be simultaneously subject to different and, not infrequently, conflicting regulatory systems. Individuals hold membership of a number of spatial and functional social systems, each of which has a regulatory system specific to it.

Regarding specifically the difference between regulation and self-regulation, a social system is self-regulating if it can make, apply and adjudicate the rules governing the behaviour of and the interaction between

its members, as well as its behaviour toward and its interaction with its social environment. In contrast, a social system is not self-regulating if these rules are imposed on it and enforced from the outside by another social actor. So, while in capitalist market economies private firms are self-regulating systems, in socialist command economies state enterprises are regulated systems.

Naturally, there are degrees of regulation and self-regulation. Even in free-market economies private firms' self-regulation is constrained by the legal framework within which they operate. Even societies are not completely self-regulating systems, because government regulation tends to be constrained by international law, treaties and conventions.

TYPES OF RULES

Irrespective of the level at which regulation and self-regulation take place within societies and between them, several types of rules may be distinguished.³ The fundamental distinction is that between formal rules (such as statute laws, by-laws, and charters) and informal rules (such as common law, customs, and conventions). The difference between them lies in that the former are designed, enacted, and formally stated (made known in written form), whereas the latter come into existence spontaneously.

As the case of traditional societies and that of informal groups in modern societies indicate, informal rules can be effective even in the absence of formal rules. In contrast, formal rules do not put an end to informal rules, as evinced by the persistence in modern societies of traditions, customs, and conventions, as well as by the occurrence in formal organizations of informal rules which support, supplement, obstruct or supersede formal rules.

Whether formal or informal, rules are either constitutive or regulative. The former are concerned with the structure of the system and the acquisition and exercise of power or influence, as well as with the system's boundary and

membership. If they did not exist, there would be no systems and no institutions. The latter are then rules regulating those instances of behaviour and interaction which are independent of them in the sense that they would take place even without them.

Besides being either constitutive or regulative, formal and informal rules are either permissive or restrictive concerning social actors' behaviour and interaction. Although explicitly or implicitly both simultaneously prescribe what social actors should do and proscribe what they should not do, permissive rules are by their nature process-orientated and, hence, goal-independent, whereas restrictive rules are by their nature goal-orientated and, hence, goal-dependent.

Since rules may be more or less permissive or restrictive, they may be located on a spectrum ranging from highly permissive (confining themselves to defining broad parameters within which social actors are free to make their own choices) to highly restrictive (specific as to both goals and means). The more permissive they are, the higher the autonomy of social actors, and vice versa.

Not only rules, but regulatory systems too are more or less permissive or restrictive. As a result of simultaneous membership of a number of social systems, individuals are simultaneously subject to a number of regulatory systems, some more permissive, others more restrictive. In this respect, the distinction between compulsory and voluntary membership is of importance: when their membership in a particular social system is compulsory, individuals have no choice but to be members, irrespective of how permissive or restrictive it is; in contrast, when their membership in a particular social system is voluntary, their choice depends less on how permissive or restrictive it is and more on how it contributes to the satisfaction of their needs and wants.

GOVERNMENT REGULATION

Like regulatory systems in general, the state may be more or less restrictive or permissive. How restrictive or permissive it is, depends on the extent and intensity of government regulation. At the same time, the extent and intensity of government regulation may vary from one sphere of human behaviour and human social interaction to another. Thus, the extent and intensity of government regulation may be located on a spectrum ranging from highly restrictive at one extreme to highly permissive at the other.

Irrespective of its extent and intensity, government regulation is a source of tensions and conflicts in society, because while some members of society may favour the existing extent and intensity of government regulation, others may favour its expansion either generally or in a particular sphere, and still others may favour its contraction, again either generally or in a particular sphere. For example, one British report distinguished five categories of voters. Depending on their attitudes towards economic and personal freedom, voters consisted of conservatives (who favoured economic freedom but wanted state regulation of personal freedom, i.e., of individual choice in moral and social issues), socialists (who distrusted economic freedom but favoured personal freedom), authoritarians (who favoured neither economic nor personal freedom), libertarians (who favoured both economic and personal freedom), and centrists (who stood in the middle of the range on both economic and personal freedom).⁴

Permissive government regulation is conducive to the autonomy (freedom) of the members of society and, hence, to self-regulation as well. However, it is not possible to determine in advance whether and how social actors will use their autonomy (freedom): while on the one hand they need not make full use of all the opportunities available to them, on the other they may show lack of self-restraint and take undue advantage of others. And

while permissive regulation is conducive to self-regulation, simultaneously it cannot dispense with it, albeit on condition that self-regulation is constrained by conventions, customs and traditions and does not endanger society's cohesion and performance.

Restrictive government regulation, in contrast, circumscribes the autonomy (freedom) of the members of society and, hence, also self-regulation. Being extensive and intensive, it tends to have an adverse impact on flexibility, innovation, and efficiency; to increase the costs connected with rule-making, rule-application, and rule-adjudication; and to lessen respect for rules and contribute to covert and overt non-compliance on the part of the members of society, one reason for non-compliance being compliance costs. Moreover, when government regulation is extensive and intensive, rules are prone to be specific rather than general, to suffer from inconsistencies, and to breed uncertainty because, besides often creating confusion, they have to be frequently modified or changed in response to both changing conditions and contingencies.

In sum, while permissive government regulation is a sign that the state is process-orientated, restrictive government regulation is a sign that the state is goal-orientated in the sense of being concerned with an end-state or final outcome. To use Giovanni Sartori's terminology, the former is characterized by the rule *of law*, whereas the latter is characterized by the rule *by laws* which nears, albeit in disguise, the rule by men.⁵ Expressed differently, the latter is characterised by a flow of *ad hoc* political and bureaucratic decisions and *ad hoc* rules.

When government regulation is extensive and intensive and it becomes apparent that it neither works nor can work as expected, calls for deregulation are likely to materialise and grow. The purpose of de-regulation is to increase the autonomy (freedom) of the members of society by curtailing government intervention in the economy and society. This requires a

reduction in the existing amount of rules and/or a change in the content of the existing rules, as well as a check on *ad hoc* (discretionary) political and bureaucratic decisions. In brief, this requires the substitution of general and abstract rules for specific and *ad hoc* rules or, in other words, process-orientated (goal-independent) rules of conduct for goal-orientated (goal-dependent) rules.

Besides these measures, deregulation may need a revision of the established rules governing rule-making. The need arises when the established rules governing rule-making enable a proliferation of *ad hoc* rules, so that goal-driven governments are able arbitrarily to enact *ad hoc* rules while nominally abiding by the established rules of rule-making.

RULE ENFORCEMENT

Rules are expected to be observed, not broken. In the real world, though, they are not always observed, but often intentionally or unintentionally broken, sometimes even by the rule-makers themselves. In modern societies, which are state societies, this applies to rules at any level of regulation and, consequently, also to legal and bureaucratic rules.

If rules are to be observed by their addressees, they must be enforced, and their enforcement is to be achieved by the use of both positive sanctions (and the promise thereof) and negative sanctions (and the threat thereof). In other words, to encourage as well as reward compliance with rules on the one hand and to deter as well as punish non-compliance with rules on the other, rule-enforcement has to rely on a combination of physical, material and symbolic means.

Although rules must be enforced if they are to be observed, some are more flexible (less rigorously applied and enforced) than others. Two main approaches to rule-enforcement may be distinguished, namely, the zero-

tolerance approach (which punishes any violation of rules, however slight) and the zone-of-indifference approach (which tolerates minor violations of rules). The more extensive and intensive government regulation, the more problematic is the zero-tolerance approach and the more necessary is the zone-of-indifference approach.

Whether flexible or inflexible, rules may permit or require exceptions, exempting certain social actors from compliance with them. According to Robert B. Edgerton, it is possible to identify four general categories of rule exceptions: exceptions based on temporary conditions, such as temporary incapacity; exceptions arising from a specific status, such as infancy, disability, or old age; exceptions connected with special occasions, such as harvest or initiation rituals or funerals; and exceptions that apply only in certain settings, such as sanctuaries.⁶

Since government-made rules must be enforced if they are to be observed, effective rule-enforcement presupposes that rules are enforceable and that government, besides being determined to enforce them even in the face of opposition and resistance, has at its disposal the requisite physical, material and symbolic resources. At the same time, the less compliance with rules is based on normative grounds (commitment), the greater the importance of material and physical means in rule-enforcement. Yet, compliance based on utilitarian (calculative, instrumental) grounds is more fragile than that based on commitment, because it has a tendency to decline when the performance of the state declines, when its ability to gratify and enforce falls.

Thus, rule-making and rule-enforcement incur costs, which have to be covered by the revenue extracted by the state from the economy by means of taxation, direct and indirect. Inevitably, the more extensive and intensive government regulation, that is, the more formalised and bureaucratised the economy and society, the more revenue the state needs and has to extract

from the economy. In any case, revenue extraction incurs extraction costs, depends on the state's not unlimited extractive capabilities, and can give rise to tax avoidance (which remains within the law), tax evasion (which breaks the law), and other forms of tax resistance (such as delays in tax payment or tax revolts).

It follows that government regulation should take into consideration not only its expected short-term and long-term benefits, but also its expected short-term and long-term costs, trying to maximise the former and minimise the latter.

CONSTRAINTS ON GOVERNMENT REGULATION

The extent and intensity of government regulation depend on the orientation of government, on whether it is process-orientated or goal-orientated in the sense of being concerned with an end-state or final outcome. In any case, though, there are limits to effective government regulation, so that the state is constrained in what it can do and attain.

Besides being constrained by the available resources and the costs of rule-making and rule-enforcement, effective government regulation is further constrained by three major factors. The first is universally valid economic and other laws, which no government regulation can put out of operation. The second is the existing political, economic and civic structures: if they are to be preserved, government regulation must not encroach on them. And the third is the values of society: the more government regulation is at odds with the values of society, the greater the likelihood of covert and overt non-compliance.

Hence, there is an important difference between *effective* government regulation and *nominal* government regulation. The difference lies in that the

former leads to compliance with the designed, enacted and formally stated rules, whereas the latter does not. That is to say, while the former regulates human behaviour and human social interaction, the latter fails to do so.

Yet, although it is easier to make rules than to enforce them, even rule-making faces constraints. One group of them is political constraints: by definition, rule-making is politically less constrained in authoritarian political systems than in democratic ones, and in democratic ones it is politically less constrained in the case of one majority party government than in the case of a coalition or a minority government.⁷

In democratic political systems, another constraint on rule-making is the constitution, which defines the parameters within which rule-making is to take place. In other words, constitutional rules are designed to control, *inter alia*, the exercise of political power and, consequently, rule-making as well. For that reason, they are also intended to be more costly to amend, modify, and replace than are operating rules.⁸

A further constraint on rule-making in democratic political systems is judicial review. It means that courts are explicitly or implicitly empowered to invalidate laws and administrative actions: while in the case of constitutional review they rule on the constitutionality of laws and regulations, in the case of administrative review they rule on the legality of administrative actions.

Besides, in democratic political systems rule-making is affected by the demands and activity of pressure groups⁹ and social movements,¹⁰ as well as by public opinion and the mood of the time. They can block change in government regulation on the one hand and enforce it on the other.

COMPLIANCE AND NON-COMPLIANCE

Although there are limits to effective government regulation, governments may develop a regulatory mentality, characterised by a belief that they are

the best judges of what is good for society and that, by means of regulation, they can solve any problem and attain any political, economic, social, and cultural objective. The inevitable result of this belief in their omniscience and omnipotence is then extensive and intensive government regulation.

Being inimical to spontaneity, extensive and intensive government regulation noticeably circumscribes the autonomy (freedom) of the members of society. At the same time, it gives rise to uncertainty, because it undergoes perpetual change. The reason is that whenever the existing rules do not produce the officially desired outcomes, the remedy is sought either in their modification or in their replacement by new ones, not in their relaxation or repeal.¹¹

In any case, government regulation affects all spheres of human behaviour and human social interaction. In the economic sphere, for instance, it has an impact on productivity, competitiveness, competition, profitability, hiring and firing, unemployment, prices and consumers' choice. Outside the economic sphere, it has an impact on, *inter alia*, access to information, communication, political activity and processes, marriage, divorce, provision of health care and education, social inclusion and exclusion, individuals' opportunities, privileges, crime and immigration.

For society, the impact of government regulation may be beneficial or harmful, depending on its extent and intensity. In principle, government regulation is beneficial if it contributes to economic, political, social and cultural development by being process-orientated and, thus, allowing spontaneity, albeit within the framework of general and abstract rules. In contrast, government regulation is harmful if it retards economic, political, social and cultural development by being goal-orientated and, thus, putting fetters on spontaneity.

Yet, whether process-orientated or goal-orientated, government regulation is a source of tensions and conflicts in society. At the same time,

the choice between compliance and non-compliance is affected by the perception of their costs, which need not be exclusively economic.

By definition, goal-orientated government regulation is more conducive to covert and overt non-compliance than process-orientated government regulation, because the former is by its nature detached from reality. Consequently, in order to avoid paralysis, at least some of the rules applying to particular situations must be broken. Thus, goal-orientated government regulation contributes to the emergence and persistence of a culture of rule-breaking.

PITFALLS OF GOVERNMENT REGULATION

It follows from the foregoing that goal-orientated government regulation can fail to attain its objectives and/or produce unintended consequences. In other words, it can fail to solve existing problems, exacerbate them, and/or create new ones. Empirical evidence is not difficult to come by, as demonstrated by the selected cases presented below.

One example of the failure of government regulation is Prohibition in the United States. In this liberal democracy, the production, sale, and transport of alcohol were outlawed between 1920 and 1933. However, the ban did not stop people drinking. It merely drove them underground, giving rise to organised crime engaged in smuggling, illicit distilling, and bootlegging. These activities, not surprisingly, involved the use of violence.¹²

Another example is the case of the communist systems established in the former Soviet-bloc countries. As variants of totalist authoritarianism characterised by authoritarian politics and political control over the economy and society, they were highly formalized and bureaucratized. Nevertheless, they had an informal dimension too, which was an unintended product of the formal system and deviated from it, in some respects complementing it, in

others eroding it. Among its elements was the second economy, brought about by the bureaucratisation of the economy and chronic shortages affecting consumers and state enterprises alike.

Illegal second economy activities were not confined to communist systems, though. They are to be found in any established modern economic system, irrespective of its type. In capitalist market economies, for instance, they have increased considerably since 1960, their major causes being the tax burden, the complexity of the tax system, and restrictive government regulation. They are also far from absent in the developing countries,¹³ as well as in the post-communist ones.

The last example concerns contemporary Britain. Since the 1997 general election, the Labour government has been obsessed with regulation. New regulatory measures have imposed additional compliance costs on business, estimated to reach £15 billion by January 2002.¹⁴ They have also imposed performance targets on the health service, social services, education, the police and local government. Besides, they were becoming a threat to the effectiveness of the armed forces as well as to individual freedom.

Despite the sharp increase in red tape, by mid-2001 Britain was still regarded as having a more business-friendly environment than other European Union countries. Nevertheless, since 1997 its global competitiveness has been gradually falling. There have been troubles with targets too, arising from their impact on behaviour: targets may encourage cheating and rule-breaking, adversely affect performance in areas not covered by them, and reduce responsiveness to real problems.¹⁵

A number of factors have contributed to the proliferation of rules and targets. They have included the government's goal-orientation, its naive belief in the inherent effectiveness of rules and targets, and its petty risk-aversion manifesting itself in, *inter alia*, its safety fanaticism, as well as the influence of regulation-demanding pressure groups and public opinion.

CONCLUSION

Whether they are traditional or modern, societies need regulation if they want to survive and prosper. Hence, regulation matters. More specifically, it matters who regulates what, when, how and why on the basis of what title, at what costs, and with what consequences.

In modern societies, one of the rule-makers and rule-enforcers is the state. This raises the important question of its role in the economy and society at large, because the role the state plays in the economy and society has an impact on the degree of autonomy (freedom) enjoyed by the members of society and, at the same time, is a source of tensions and conflicts in society.

These tensions and conflicts arise from differences in social actors' interests. Social actors, be they individuals or social systems, are motivated first and foremost by their own interests, and the pursuit of self-interest then determines social actors' attitudes towards the role of the state in the economy and society and, thus, towards the extent and intensity of government regulation. And since social actors' interests differ, also their attitudes towards the extent and intensity of government regulation differ.

As a result of these tensions and conflicts, the extent and intensity of government regulation undergo change. In fact, over the last five centuries modern societies have experienced regulation-deregulation cycles, with regulation-orientated periods (characterised by governments obsessed with regulation) followed by spontaneity-orientated periods (characterised by governments showing regulatory restraint) and spontaneity-orientated periods giving way to regulation-orientated periods.

While temporary fluctuations in the extent and intensity of government regulation tend to be triggered off by contingencies such as war or natural

disasters, regulation-deregulation cycles reflect mood swings (change in preferences) brought about by social actors' perception of a widening gap between their expectations and reality. Regulation-orientated periods begin to come to their end when the enforcement costs of government regulation begin to exceed its benefits, when non-compliance begins to be common rather than rare, and when government regulation begins to fail to attain its objectives. In contrast, spontaneity-orientated periods begin to come to their end when government regulation begins to be regarded as a panacea and when security (protection against any contingency) begins to be valued more than freedom.

Neither regulation-orientation nor spontaneity-orientation is peculiar to a particular type of modern political system. That is to say, the extent and intensity of government regulation do not depend on whether the established political system is authoritarian or democratic. Both can be either restrictive or permissive, albeit with the proviso that authoritarian political systems are by their nature restrictive in the political sphere.

Although the extent and intensity of government regulation can give rise to tensions and conflicts in any type of modern political systems, in democratic political systems they can also give rise to a tension between democratic procedures of governance and goal-attainment. The reason is that in these systems the goal-orientation of the elected government can lead to the subordination of democratic procedures of governance to goal-attainment, to an authoritarian or control-freak style of governance which discards those democratic procedures of governance that inhibit goal-attainment.

In contemporary societies, not surprisingly, government regulation continues to play an important role. Yet, and again not surprisingly, the state is not a monopoly rule-maker and rule-enforcer. Inevitably, it has to compete

with a wide range of other rule-makers and rule-enforcers, intrasocietal as well as extrasocietal, who constrain its freedom of action.

Both permissive and restrictive government regulation continue to have their ardent proponents and opponents. Nevertheless, belief in the inherently beneficial effects of government regulation remains widespread in many societies, and most governments still have a penchant for incessant regulative activity.

There are, however, compelling reasons for encouraging spontaneity, albeit within a stable framework of general *ex ante* rules. Modern societies are complex systems. Moreover, the world is currently in dynamic flux, which creates problems calling for solutions. But different social actors face different problems which need tailored solutions. Therefore, problems should be solved at the ground level, where individuals have a vested interest in a satisfactory solution.

Since extensive and intensive government regulation stifles spontaneity, it retards societal development. On top of that, it can fail to attain its objectives and/or produce unintended consequences. In other words, it need not solve existing problems and can create new ones.

At the same time, government regulation takes place in a world which is interdependent, made up of nation-states pursuing their own interests, and differentiated in economic, political, social and cultural terms. This diversity of national interests and conditions constitutes a constraint on the extent and intensity of effective supranational (regional and global) regulation, even in the case of the European Union. As are individual societies, the world too is characterized by a web of formal and informal regulation and self-regulation, by a plurality of regulatory systems.

NOTES

1. In the formulation of F.A. Hayek, 'a rule refers to an unknown number of future instances and to the acts of an unknown number of persons, and merely states certain attributes which any such action ought to possess.' (*The Mirage of Social Justice*, London, Routledge & Kegan Paul, 1976, p. 14.)
2. As put by Michael Laver, 'even in societies dominated by a Leviathan, much day-to-day social interaction is beyond the purview of the state and must perforce be governed along anarchistic lines.' (*Private Desires, Political Action: An Invitation to the Politics of Rational Choice*, London, SAGE Publications, 1997, p. 45.)
3. On the typology of rules see e.g. A.J.M. Milne, *Ethical Frontiers of the State: An Essay in Political Philosophy*, Basingstoke, Macmillan, 1998, pp. 51-58, and Francis Fukuyama, *The Great Disruption: Human Nature and the Reconstitution of Social Order*, London, Profile Books, 2000, Chapter 8.
4. John Blundell and Brian Gosschalk, *Beyond Left and Right: The New Politics of Britain*, London, The Institute of Economic Affairs, 1997, IEA Working Paper No. 1. See also David Smith, 'The ascent of political man,' *The Sunday Times*, 7 December 1997, p. 4.10.
5. Giovanni Sartori, *The Theory of Democracy Revisited*, Chatham, New Jersey, Chatham House Publishers, Inc., 1987, pp. 324-326.
6. Robert B. Edgerton, *Rules, Exceptions, and Social Order*, Berkeley, University of California Press, 1985, pp. 33-34.
7. Some propositions concerning the impact of the electoral system and the type of government on comprehensive public sector reforms and market-oriented reform policies are to be found in Markku Olavi Harrinvirta, *Strategies of Public Sector Reform in the OECD Countries: A Comparison*, Helsinki, The Finnish Society of Sciences and Letters, 2000, pp. 143-147.

8. On flexible and rigid constitutions see Arend Lijphart, *Patterns of Democracy: Government Forms and Performance in Thirty-Six Countries*, New Haven, Yale University Press, 1999, pp. 218-223.
9. J.L. Porket, *Modern Economic Systems and their Transformation*, Basingstoke, Macmillan, 1998, pp. xvi-xvii, 36-37, 116-117 and 255.
10. According to Robert O'Brien et al., social movements are anti-systemic and rely on mass mobilisation. (*Contesting Global Governance: Multilateral Economic Institutions and Global Social Movements*, Cambridge, Cambridge University Press, 2000, p. 12.) However defined, though, they should be regarded as a subset of norm-setting pressure groups.
11. J.L. Porket, *Work, Employment and Unemployment in the Soviet Union*, Basingstoke, Macmillan, 1989, p. 186.
12. A less known case concerns off-course betting in Britain, which did not disappear between 1853 and 1961, although legally prohibited.
13. In the developing world, according to some estimates, 50-75 per cent of all working people participate in the second economy, the size of which amounts to between one-fifth and more than two-thirds of the total economic output of the Third World. (Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, London, Bantam Press, 2000, p. 75.)
14. David Smith, 'Labour's red tape strangles economy,' *The Sunday Times*, 6 May 2001, p. 3.4. For estimates of the total additional cost to business, including tax increases, see Nicholas Boys Smith, *No Third Way: Interfering government and its cost to business*, London, Politeia, 2001.
15. To give an example, the performance targets set by the rail regulator have encouraged train operators to stretch journey times in their timetables to minimise the risk of trains arriving late, so that some

journeys now take longer than they did 100 years ago. (*The Economist*, 9 June 2001, p. 47.)