Lessons for the regulation of new industries

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Research Seminar on Prostitution in South Africa

Pretoria, 15 April 2010

Overview of presentation

- Introduction
- When should a sector be regulated or shut down
- Principles for regulation
  - Objectives of regulation
  - Prohibitions
  - Licensing/registration
  - Intermediaries
  - Enforcement
- Research suggestions
- Concluding thoughts

Introduction

- Debates about the legalisation of illegal industries are not new in RSA
  - Gambling industry was legalised in 1996
  - Significant illegal industry existed
  - The Minister of Trade and Industry recently appointed a Gambling Review Commission to review current gambling policy
  - Commission considering whether the original regulatory objectives were met, socio-economic impact of gambling, and legalisation of new gambling activities
  - Still significant illegal gambling: dog racing, fafee, person-to-person betting, poker houses
- Some general principles can be identified, which may be applicable to other sectors

Decisions to legalise/prohibit

- Is a prohibition enforceable?
  - Size and nature of the illegal market
  - Nature of the industry
  - Regulatory/enforcement capacity
- Is this aligned with the moral position of society?
  - Big repeated debates about a number of activities in the 1990s: gambling, money lending
  - Choice: should the sector be prohibited or regulated
- Can regulation bring other benefits:
  - Protection of the vulnerable or consumers
  - Revenue for the state or other social investments

Objectives of regulation

- Combination of demand and regulatory space provides strong impetus for market development
  - Microlending market: in 1992, when a first exemption was put in place, there was no market. Ten years later, a R10bn formal industry had been created.
- There will be an industry – important to think through a vision for the industry, have clear objectives and structure the regulation accordingly
  - Credit market: 2002 research established a split market with very limited product range and high costs for the low-income market. Vision was for a unified market with more and cheaper products for low-income consumers
  - Gambling: Vision was for limited legal gambling opportunities to minimise social impact and for revenue generation and social investment by industry.

Prohibitions

- Need to have clear idea of types of behaviour to be prohibited upfront
  - Combination of knowledge of current abuses and international practice – regulation does not always have to follow market practice, but can lead
  - Principle vs.. rules based regulation
- 2 approaches to prohibition:
  - Everything is allowed unless prohibited
  - Nothing is allowed unless permitted (and possibly licensed) – e.g. gambling: 1996 vs.. 2004 legislation

Licensing or registration

- Will there be licensing/registration?
- How open or closed a system?
- Licensing/registration a privilege or a right?
- Regulatory constraints: bringing existing players into the regulatory net can impose great strains on administrative capacity
  - Transitional merger review in Competition Act
  - FAIS registration
  - Liquor license conversions

Licensing or registration

Regime	Description	Possible impact
Strict licensing	Entry restricted through strict requirements e.g. tax registered etc Example: Gambling – only 40 casino licenses in the country	Encourages black market – need for significant enforcement capacity, although legal industry will assist with enforcement;
Open registration	Everyone welcome as long as registered – minimal entry requirements Examples: New company registration envisaged, credit providers	Can put pressure on regulatory capacity, especially initially when people come into the regulatory net; want an automatic system with some transitional powers; compliance requirements; difficulties with enforcement

Intermediaries

- Any regulation creates scope for intermediaries, usually to navigate the regulation or to assist with enforcement of rights;
- Intermediaries often exploit lack of knowledge and impose unnecessary or unjustified costs
- Anticipate emergence of intermediaries and create scope in the legislation for their regulation

Enforcement

- Criminal vs. administrative penalties
- Trend internationally and locally has been to decriminalise, but not always effective
- Penalties only effective if there is either a real danger of being caught and/or if the penalties are sufficiently high to act as a deterrent
- Industries tend to budget for penalties
- Regulatory capacity needs to be carefully evaluated – one of our biggest constraints in SA

Enforcement

		Impact
Criminal	Police investigation and referral to the prosecutors Results in fines and/or imprisonment	Competes with other cases in courts; imprisonment can have deterrent effective, if there is a likelihood of being caught and convicted
Civil	Private enforcement in courts	Not relevant for sector
Administrative	Fines or other penalties such as withdrawal of registration	Can be effective if fines are sufficiently high; registration withdrawal can be viewed seriously

Research issues

- Good data on the industry:
  - number of participants/service providers,
  - number and nature of intermediaries,
  - different market segments and customers,
  - market practices and abuses in the current system
- Data is important for
  - Establishing a baseline to evaluate policy implementation and socio-economic impact
  - Develop policy objectives and target policy instruments
  - Measure policy impact on an ongoing basis
- International regulatory frameworks

Closing thoughts

- If a sector has persisted and there is no clear commitment to enforcing prohibitions, regulation should be considered
  - At least vulnerable parties can receive some protection and state can generate some revenue through taxation;
- However, the regulatory regime needs careful and thorough consideration, as legalisation creates market development impetus
- Too often, we leave important considerations relating to regulatory capacity to the end, after legal framework has been developed, or consideration international provisions without consideration of local implementation capacity constraints