Lessons for the regulation of new industries

Astrid Ludin
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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

<table>
<thead>
<tr>
<th>Regime</th>
<th>Description</th>
<th>Possible impact</th>
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<tbody>
<tr>
<td>Strict licensing</td>
<td>Entry restricted through strict requirements e.g. tax registered etc</td>
<td>Encourages black market – need for significant enforcement capacity, although legal industry will assist with enforcement;</td>
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<td>Example: Gambling – only 40 casino licenses in the country</td>
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<tr>
<td>Open registration</td>
<td>Everyone welcome as long as registered – minimal entry requirements</td>
<td>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</td>
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<td>Examples: New company registration envisaged, credit providers</td>
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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

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