



ALTERUM Centre for Research and Analysis of Financial System

**Proposal of a model for assessing the observance of the principle of  
proportionality (OPP)**

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**Introduction**

The development and implementation of effective and efficient legal regulations are addressed by many theoretical concepts, approaches, programs and methods of regulatory improvement.<sup>1</sup> In spite of constantly broadening knowledge, gathering more and more experience and skills in the development and enforcement of regulations, their quality, at a national or international level, raises many reservations. This situation results from a countless number of factors; one of them is a rapidly progressing process of creating more and more new regulations. Developing supranational regulations involves a problem; it relates to taking account of significant differences in the level of economic development of countries, differences resulting from different legal, political, social systems or established legal cultures. Undoubtedly, any significant differences between countries as well as internal differences affect attitudes and behaviors of the regulated entities. Their opinions, by different divisions (countries, industries, companies, key stakeholders), on fair distribution of the assessment of regulatory benefits, costs and related risk differ significantly. If these differences are not included in the process of development and implementation of regulations, their effectiveness and efficiency decrease significantly. It manifests itself in the fact that some regulated entities may search for any actions aimed at delaying the process of implementing new regulations or at regulatory evasion, or try to implement regulations at a minimum level of burdens and costs, and even expose themselves to high costs of fines for non-compliance with these requirements. These behaviors

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<sup>1</sup> It is worth stressing publications by employees of such institutions as :CARR LSE London, OECD, Bruegel Institute, Peterson Institute or a team led by Professor N. Gunningham, Australian National University. Presently, the EU is executing an important regulatory program “*Better Regulation*”.

will emerge when these entities consider that the distribution of benefits, costs or risk is a sign of absolute or relative injustice.

In this article an attempt is made to assess regulatory impact with reference to a popular principle of proportionality. However, this principle undergoes large modifications; its interpretation is broadened and it gets adapted to the factual assessment of legislative processes. The origin of the principle of proportionality cannot be indicated unambiguously. It has many dimensions; its functions, components and scope of use are often hardly noticeable, and the scope of use depends largely on the legal system<sup>2</sup> and the legislative context<sup>3</sup>. In the everyday interpretation, its essence comes down to the use of a relevant tool, so that the statement “Never use a cannon to kill a fly” does not become applicable. The origin of the principle of proportionality is attributed to a ruling of the European Court of Justice of 1956 that established it as a general principle of Community law.<sup>4</sup> The notion of the principle of proportionality has evolved<sup>5</sup>; it has many alternative terms. For the purpose of this paper, the following definition is adopted: “the principle of proportionality requires that acts of Community institutions not to exceed the limits of what is adequate and necessary to meet justified objectives set out by a specific regulation; it means that when there is a choice between several adequate means, the least restrictive means should be chosen, whereas arising inconveniences should not be excessive as compared to the intended objectives”.<sup>6</sup> Thus, the principle of proportionality includes three significant elements: adequacy, necessity and proportionality *sensu stricto*. Consequently, the observance of the principle of proportionality in the law-making process comes down to three significant stages. The first one is interpretation of the subjective scope of at least three abovementioned components. The second stage consists in transformation of the adopted scope into clear and quite simple criteria. The third stage is attributing relevant measures to particular criteria.

The proposed approach to regulatory impact assessment has been termed as the model of the Observance of the Principle of Proportionality (OPP). In the article, the authors present the model assumptions, identify and particularize the criteria of main areas of the principle of proportionality, namely, the principle of adequacy, necessity and proportionality *sensu stricto*, and then determine its scoring methods. The final result of the article is a synthetic calculation: an ordered measure of the observance of the principle of proportionality for a specific regulation.

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<sup>2</sup> *Proportionality and Balancing in WTO Law: A Comparative Perspective*. EAIEL Policy Paper No. 2, November 2006, p. 14.

<sup>3</sup> The principle of proportionality requires, for instance, a larger scope of restrictions for financial institutions and actions that generate a greater risk.

<sup>4</sup> T. Białek, M. Grabowska, P. Brewiński, *Ekspertyza prawna dotycząca zasady proporcjonalności w europejskim prawie wspólnotowym i polskim porządku prawnym*. Center for Banking Law and Information of the Polish Bank Association Warsaw, p. 5.

<sup>5</sup> E. Engle, *The history of general principle of proportionality: a overview*. “The Dartmouth Law Journal” Vol. X Winter 2012.

<sup>6</sup> Body of rulings of the National Farmers Union, quot. T. Białek, M. Grabowska, P. Brewiński, *Ekspertyza prawna dotycząca, ...op.cit.* p. 17.

## **1.1. Idea and justification for a model for observing the principle of proportionality (OPP)**

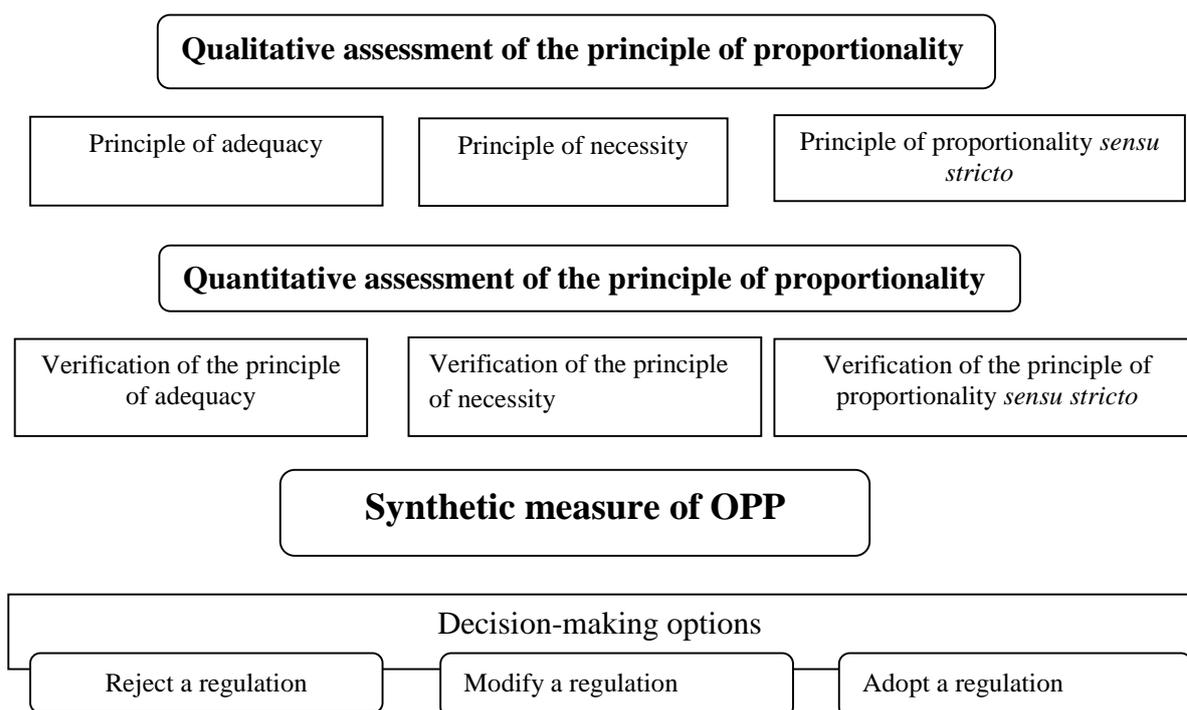
We are convinced that a large number of actions should be taken in various areas to improve the quality of regulations, but the most important procedure in this respect is a consistent and reliable analysis of the legislative impact assessment with the use of a structured methodology. It focuses, like in a lens, strengths and weaknesses of a draft (planned) regulation. The starting point for building such a methodology is reliance on the approach we propose – the OPP model. It consists of two interacting parts, although works in each of them are autonomous. In the first part, a qualitative assessment is conducted; conditions, objectives and threats related to a specific regulation are assessed. The analysis covers the observance of the principle of proportionality. This qualitative result is a substantive contribution to the development of another, quantitative part, namely quantification of the degree of observing the principle of proportionality. Apart from showing a summary result of the assessment of observing the principle of proportionality with the use of a standardized index, this model stresses weaknesses and strengths of its major components, namely of the principles of adequacy, necessity and proportionality *sensu stricto*.

An expanded hybrid approach is even more justified since these regulations are highly complex objects of research, due to the number of entities, large subjective scope, dynamic character of relations being analyzed and hardly examined relationships between key stakeholders. Moreover, a breakdown of this model into two parts results from the fact that each regulation is an innovation, to a smaller or greater degree; consequently, we do not have an adequate information base. Conducting a qualitative analysis of observing the principle of proportionality provides more reliable indications for the creation of databases of this type and, at the same time, development of quantitative methods that may be useful in the decision-making process.

This presentation of the model is supported also by the fact that the process of developing, implementing and applying regulations involves participation of direct and indirect stakeholders with different preparation and perception of regulatory impact, and who represent different spheres of impact on economic, legal, social and ecological effects. Information and conclusions from the application of the OPP model must be thus clear and cannot come down only to one layer of assessment, namely to its qualitative or quantitative layer.

An important and even key condition of applying the OPP model is a growing share of international regulations in operations of companies and financial institutions, both in Poland and in other countries. Consequently, it proved necessary to assess relatively quickly draft concepts of regulations in terms of their impact on operations of national entities and, at the same time, to develop adequate tactics and strategies of regulatory action, so as not to be doomed only to regulatory failures or accidental successes.

Chart 1.1 **Model for assessing the observance of the principle of proportionality (OPP)**



Source: prepared by the authors.

## 1.2. Qualitative assessment of observing the principle of proportionality

A theoretical and practical problem emerges: what are the criteria of assessing the use of the principle of proportionality in the law-making process? To some extent, to assess regulations, it is possible to use methods taken from the developing field of project management, taking account of various verification criteria. The team led by Professor M. Trocki recommends four groups of measures: adequacy, effectiveness, efficiency and durability of effects<sup>7</sup>. In this paper, we propose indexes similar to the ones for regulatory activity, which implies the use of the following criteria: management, legal, financial and socio-economic (table 1.1)<sup>8</sup>. The management criterion defines the degree in which the whole process of drafting and implementing regulations is managed effectively. The legal criterion explains, in turn, the degree in which a specific regulation is consistent with the existing legal order. The financial criterion addresses financial burdens generated by the principle of proportionality and its impact on autonomous effectiveness of regulations, expressed in monetary units. The socio-economic criterion tries to determine the degree in which a regulation takes account of general social and macroeconomic aspects.

<sup>7</sup> See *Ocena projektów – koncepcje, modele, metody*, ed. M. Trocki, M. Juchiewicz, Oficyna Wydawnicza SGH, Warsaw 2013.

<sup>8</sup> S. Kasiewicz, L. Kurkliński, W. Szpringer, *Raport Specjalny: Zasada proporcjonalności a polski system bankowy*, “Bank” 2013, No. 12.

**Table 1.1 Recommended criteria for testing the principle of proportionality**

<b>Elements of the principle of proportionality</b>	<b>Proposed criteria</b>
<b>Adequacy</b>	<p><b>1. Management</b></p> <ul style="list-style-type: none"> <li>• Were the objectives specified adequately?</li> <li>• Does the regulation result in meeting the objectives?</li> <li>• Are there in place sufficient resources (tangible, human, intangible) and competences to implement the regulation?</li> <li>• Was the unit responsible for implementing the regulation appointed?</li> <li>• Were the draft regulation implementation schedule and budget prepared?</li> <li>• Is cohesion of action maintained in the short, medium and long run?</li> <li>• Does the organizational culture of units covered by the regulation foster its implementation?</li> <li>• Is the determination to implement the regulation strong?</li> <li>• Is regulatory success clearly formulated?</li> <li>• Is the motivation system included in the process of drafting and implementing the regulation?</li> </ul> <p><b>2. Legal</b></p> <ul style="list-style-type: none"> <li>• Is the regulation contradictory or highly conflicting with the existing legal order?</li> <li>• Were key legal risks identified?</li> <li>• Were key stakeholders of the regulation identified?</li> <li>• Does the regulation breach the effective competition principles?</li> <li>• Does the regulation breach the market mechanism principles?</li> <li>• Was the regulation monitoring method (scope, procedures, documents, dates) adopted?</li> </ul> <p><b>3. Financial</b></p> <ul style="list-style-type: none"> <li>• Will the regulation bring a significant deterioration in the financial position of the affected entities?</li> </ul> <p><b>4. Socio-economic</b></p> <ul style="list-style-type: none"> <li>• Will consultations associated with the draft regulation involve significant stakeholders?</li> <li>• Will achievement of the regulation’s objectives result in increase in well-being of the society?</li> </ul>
<b>Necessity</b>	<p><b>1. Management</b></p> <ul style="list-style-type: none"> <li>• Were justified alternative solutions chosen for the regulation?</li> <li>• Were major burdens resulting from these solutions identified?</li> <li>• Will the calculated burdens generate additional risk for the regulated units (excessively complex management, large scope of control, etc.)?</li> <li>• Were these burdens estimated?</li> <li>• Were these solutions assessed in terms of efficiency and risk?</li> </ul>

	<p><b>2. Legal</b></p> <ul style="list-style-type: none"> <li>• What is the assessment of the regulated unit’s ability to accept self-regulatory solutions?</li> </ul> <p><b>3. Financial</b></p> <ul style="list-style-type: none"> <li>• What will be the impact of estimated burdens resulting from the draft regulation on the regulated units’ financial performance?</li> <li>• What will be the impact of estimated burdens resulting from alternative solutions on the regulated units’ financial performance?</li> <li>• How large is the risk of errors in the valuation of regulatory burdens?</li> </ul> <p><b>4. Socio-economic</b></p> <ul style="list-style-type: none"> <li>• Will burdens result in decline in trust in the State due to unequal legal treatment of units, injustice, growing regulatory competition?</li> </ul>
<p><b>Proportionality</b> <i>sensu stricto</i></p>	<p><b>1. Management</b></p> <ul style="list-style-type: none"> <li>• Are costs related to the specific regulation identified or valued?</li> <li>• Are benefits related to the specific regulation identified or valued?</li> <li>• Are measures to be achieved by the regulator defined?</li> <li>• Is regulatory impact assessed in relation to the regulated entities, sectors and the economy?</li> <li>• Are there in place resources and skills for the valuation of social costs and benefits resulting from the specific regulation?</li> </ul> <p><b>2. Legal</b></p> <ul style="list-style-type: none"> <li>• Are institutions responsible for monitoring and assessing the achieved effects of the whole regulatory process identified?</li> <li>• Is the regulator aware of the hierarchy of objectives of the regulation being implemented?</li> <li>• Are the conditions for objective and reliable public consultations created?</li> </ul> <p><b>3. Financial</b></p> <ul style="list-style-type: none"> <li>• Is the regulatory impact assessment methodology (RIA, <i>Benefit-Cost Analysis</i>) applied?</li> <li>• Are legal and regulatory risks measured?</li> <li>• Is regulatory impact on risk reduction assessed?</li> </ul> <p><b>4. Socio-economic</b></p> <ul style="list-style-type: none"> <li>• Are preferences with regard to (national, EU) authorities’ regulatory policy clearly addressed?</li> <li>• Is progress in the regulatory impact assessment process shown?</li> </ul>

Source: prepared by the authors.

It is worth emphasizing that these are proposals of particularizing the principle of proportionality with regard to its main elements. The criteria can be changed completely, broadened or narrowed, depending on the special character of a draft regulation. Thanks to this description, the principle of proportionality is a highly flexible regulatory impact assessment method.

### 1.3. Quantification of the principle of adequacy

In the article published in “Bank” in December 2013, we presented a concept of assessing draft regulations in terms of the principle of proportionality<sup>9</sup>. The assessment was qualitative, and it consisted in an analysis of three pillars of the principle of proportionality, namely, adequacy, necessity and proportionality *sensu stricto*. We suggested that each of partial principles comprising the principle of proportionality should be subjected to numerous criteria in the analysis, which were relating to four problem areas: management, legal, financial and socio-economic area.

A shortcoming of this approach is, among other things, a difficulty in determining general level of observing the principle of proportionality in respect of the specific regulation. To sum up, whether or not the regulation ignores the principle completely, observes it to a moderate or prevailing degree, maybe even in 100%? Apart from a general assessment of observing the principle of proportionality, which is useful for the legislative practice, it would be thus useful to search for quantifiable measures and aim at using a synthetic measure of effectiveness of the analyzed regulation.

We can present that a measure of the principle of proportionality of a specific regulation fulfills the following condition:

$$(1) \text{ } ^\wedge\text{OPP} = p_1 * \text{PA} + p_2 * \text{PN} + p_3 * \text{PS}$$

where:

RZP – measure of observing the principle of proportionality (assumes discrete values from the range [0;6] points;

PA – average measure of observing the principle of adequacy (assumes discrete values from the range [0;6] points;

PN – average measure of observing the principle of necessity (assumes discrete values from the range [0;6] points;

PS – average measure of observing the principle of proportionality *sensu stricto* (assumes discrete values from the range [0;6] points;

$p_1; p_2; p_3$  – weights of importance of partial principles of proportionality (assume values from the range (0;1);

and the weights fulfill the condition: (2)  $p_1 + p_2 + p_3 = 1$ .

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<sup>9</sup> Ibidem.

To obtain a standardized measure of observing the principle of proportionality, which assumes values from the range [ 0;1], it is sufficient to use the following formula:

$$( 3 ) \text{ OPP} = \frac{\text{^OPP}}{6}$$

Following the pragmatics of the adopted OPP model, the entity that makes the decision on implementing the regulation may, on the basis of its value:

- (a) reject the regulation because of non-observance of the principle of proportionality when the OPP index assumes values from the range < [0; 0.33];
- (b) conclude that the regulation observes the principle of proportionality when the OPP index assumes values from the range [0.34; 0.66];
- (c) conclude that the assessed regulation observes the principle of proportionality when the OPP index assumes values from the range < [0.67; 1].

**Calculation procedure of observing the principle of adequacy**

Table 1.2 Assessing the observance of the principle of adequacy

Criterion	Criterion score from 0 to 6 points
1. Relationship between the regulator’s objectives and the regulation.	
2. Scope of the regulatory impact on causes of a problem.	
3. Available resources and motivation system of the regulator.	
4. Stakeholders’ interests versus the regulation.	
5. Making use of behavior of key stakeholders.	
6. Regulatory risk.	
7. Enforcing the regulation.	

Source: prepared by the authors.

***Relationship between the regulator’s objectives and the regulation***

Prior to determining the casual relationship between the regulation’s objectives and the adopted wording, it is worth analyzing general conditions that are decisive for the introduction of new draft regulations. Table 1.3, containing typical reasons for legislative action, is helpful in this respect.

**Table 1.3 Justifications for draft legislations**

Type of legitimization	Main area of regulation	Example
Natural and other monopolies	<ul style="list-style-type: none"> <li>• Tendencies to price growth and decrease in production.</li> <li>• Bundle of benefits resulting from scale effects.</li> <li>• Identification of whether or not a monopoly is authentic.</li> </ul>	Public utility companies.
Windfall gains	<ul style="list-style-type: none"> <li>• Transfer of benefits, resulting from growth in windfall gains of a company, to customers or a taxpayer.</li> </ul>	A company discovers an extremely cheap source of supplies.
External effects	<ul style="list-style-type: none"> <li>• Full costs of production or consumption that affect third parties or the society.</li> </ul>	River contaminated by a factory.
Inadequate information	<ul style="list-style-type: none"> <li>• Information for customers enabling them to make market decisions.</li> </ul>	Pharmaceutical goods, foodstuffs and beverages - labeling.
Continuity and availability of services	<ul style="list-style-type: none"> <li>• Ensured provision of desired services (or protection of a minimum level of basic service provision).</li> </ul>	Transportation services have a hindered access to certain regions.
Anti-competitive and aggressive price behaviors	<ul style="list-style-type: none"> <li>• Counteracting anti-competitive behaviors.</li> </ul>	Offering services below costs.
Public goods and the so-called <i>moral hazard</i>	<ul style="list-style-type: none"> <li>• Division of costs and benefits is determined, but there are certain players who want to take advantage of gaps so as not to incur costs or to get higher benefits, the so-called <i>free-riders</i>.</li> </ul>	Defense services, safety services, health and medical services.
Unequal bargain force of competitors.	<ul style="list-style-type: none"> <li>• Protection of sensitive interests that are not protected by the existing market mechanisms.</li> </ul>	Health and medical, and work safety services.
Scarcity of goods	<ul style="list-style-type: none"> <li>• Determination of the principles of allocating scarcity goods.</li> </ul>	Gasoline shortage.
Need for coordination	<ul style="list-style-type: none"> <li>• Ensured effective production when transaction costs include positive network effects or scale effects.</li> <li>• Standardization</li> </ul>	Disproportions in agricultural production and fishery.
Planning	<ul style="list-style-type: none"> <li>• Protection of future generations' interests.</li> <li>• Coordination of altruistic behaviors.</li> </ul>	Environmental protection
Human rights	<ul style="list-style-type: none"> <li>• Protection of weaker citizens.</li> </ul>	Discrimination  Embryology.
Social protection	<ul style="list-style-type: none"> <li>• Pursuing social solidarity.</li> </ul>	Mass media.

Source: R. Baldwin, M. Cave, M. Lodge, *Understanding Regulation. Theory, Strategy, and Practice*, Oxford University Press, Oxford, New York, 2012, p. 24

Zero is granted when there is no casual relationship between the adopted objectives and rules of operations of the entities affected by the specific regulation. A huge problem emerges when the regulator's objectives are not formulated in regulatory provisions at all or are not particularized and are too general, insufficiently expressed (only in terms of quality) without

exact terms and possibilities of verifying their achievement. The practice used effectively for assessment consists in checking documents that justify the specific regulation or a regulatory impact assessment report. However, we should remember that in relation to certain acts drawing up a legislative impact report is not required, for instance, for draft acts submitted by the members of parliament. As a matter of fact, when it is not possible to define the regulation's objectives unambiguously, 0 will be granted to this criterion.

A specific criterion obtains the maximum score when we have enough evidence confirming the conduct of national, foreign research, and an analysis of results of the previously adopted legislation, which indicate a casual relationship between the set regulator's objectives and the draft regulation. Moreover, it is understood that under these circumstances the regulation's objectives are logical and precisely defined.

### ***Scope of the regulatory impact on causes of a problem***

Regulations may determine causes or symptoms of a problem that was noticed, analyzed and resulted in the development of a draft regulation. Although the theoretical bases for regulatory assessment indicate that it should affect causes of a problem, in the present market conditions (not only in medicine, but also in finance!) regulations are usually aimed at limiting alarming symptoms, for instance, most anti-crisis regulations after 2007. And thus, when they result in reduction in factors which are the sources of alarming phenomena, e.g. increase in financial exclusion of bank customers, the maximum score can be granted. In turn, the worst score is granted to this criterion when problems are not analyzed reliably, and a regulation originates from stereotypical indications or relationships that are apparently logically justified but, in fact, meet other objectives and solve other problems (e.g. the Act "A Family in Its Own Home", which was aimed to increase the availability of apartments for young people but, in fact, developers and banks proved its main beneficiaries).

### ***Available resources and the motivation system of the regulator***

Resources and motivation fulfill an important role in the process of achieving regulatory efficiency and effectiveness. If the regulator is unable to determine the actual level of required expenditures on the development, implementation and enforcement of a draft regulation, the risk of non-achievement of objectives grows and regulatory effectiveness decreases, which raises protests of the concerned parties and jeopardizes the reputation of state institutions. At this point, several alarming trends are worth mentioning. The regulatory administration aims at a situation where draft regulations can be executed nearly on a costless basis, as part of standard and fixed employee tasks. This approach comes down to a situation with prevailing savings at every stage. As a result, conducting important analyses is limited or cost assessment comes down only to the phase of developing a new draft since other items were not included in the regulators' annual budgets. Other items of regulatory costs remain beyond their sphere of interest. Owing to the complexity of draft regulations, the lack of analyses, experiments and scenarios causes the emergence of unexpected threats, which, in turn, results in low final quality of draft regulations. At the same time, employees of administration units who are necessary, to a different extent, in the legislative process feel formally taken for a ride since, not infrequently, these activities are not included in the scope of their duties. They are thus burdened with tasks

to be executed without sufficient support. As a rule, the motivation system is not planned, either. In view of the above, employees try to reduce excessively their involvement, chose options that are careful from their point of view, delay various activities or evade them deliberately.

At this point, it is worth realizing that in Poland regulatory culture prevails, and this culture can be described as confrontational and repressive. It means that regulated entities are aware that authorities are characterized by a high degree of arrogance (“they know better”, they reject most comments submitted during public consultations and sometimes they do not conduct public consultations). According to another prevailing belief, which is “a cultural heritage” of the period of real socialism, failure to adapt to regulatory obligations involves, first of all, numerous formal and informal penalties. As a result, draft regulations that would contain also positive incentives for their implementation (which is the case of many EU countries for instance in the UK) are missing.

The minimum score should thus be granted to regulations without approved regulatory budgets, which reduce excessively the scope of carried out analyses and stages of regulatory life cycle and do not try to make use of the elements of positive stimulation for the regulated entities to make them comply with the new legislations.

The maximum score is granted to regulations with adequate resources (tangible, human and information) and an organized motivation system (both penalties and awards).

### ***Stakeholders’ interests versus the regulation***

When analyzing the character of the legislative processes, it can be concluded that effects of their works divide stakeholders into two classes: winners and losers. A regulation is effective if it is definitely achieved as a result of a compromise of growth in social well-being. Thus, it is important to identify groups that obtain benefits from the regulation implementation and also groups that incur additional costs, which, however, do not result in administrative inhibition of their development, weakening innovation processes or willingness to invest. Therefore, in the case of developing initial regulatory assumptions, we cannot confine ourselves to an analysis of direct stakeholders; third parties also should be included. Typical stakeholders are:

- inhabitants;
- whole society;
- business entities (companies, financial institutions);
- customers
- administrative units (local, regional, national and EU));
- third countries (beyond EU).

The principle of proportionality is breached directly if stakeholders are not identified correctly and if costs and benefits arising from a regulation are not connected.

Consequently, the lowest score is granted to regulations that ignore an exact analysis of stakeholders, where net impact of regulations is not calculated, public consultations are not conducted, and where regulators do not contact stakeholders in the process of developing assumptions and final versions of regulations. On the contrary, when regulations fulfill all the significant conditions, they can be granted the highest score.

### ***Making use of behavior of key stakeholders***

While assessing this criterion, it is worth paying attention, first of all, to all three groups of stakeholders, namely the regulator, the regulated entity and third parties. The lowest score is granted to the criterion when:

- the regulator shows a low level of involvement in the examination of regulatory impact on management and the necessity to issue additional rules, ordinances, in responding to presented interpretation doubts, or when it only takes account of the achievement of objectives of a narrow group of stakeholders;
- the regulated entities have a strong negative attitude towards the scope of a regulation, severity of its rules, they challenge its reasonable character and, at the same time, their reservations are ignored (total lack of explanations of the reasons for rejection) or not considered, and a superficial justification is given for this state of affairs;
- third parties show a high level of dissatisfaction and warn of taking actions aiming at limiting or holding back the introduction of a specific regulation.

This criterion is highly significant depending on circumstances that accompany the regulation development process, such as:

- regulatory rush or even “express delivery”;
- the regulation is highly repressive;
- the regulation contains parametric sizes, for instance, in relation to the applied means, with a high probability of frequent modifications (for instance in the case when values are assumed arbitrarily and are not supported by analyses);
- public consultations are accompanied by a disrespectful attitude to the regulated entities.

The maximum score is granted to this criterion when almost all key stakeholders give consent to the adopted objectives of a regulation and are convinced of the justified character of the applied regulatory means. Moreover, the regulator shows a high level of involvement and complies consistently with the agreed standards and requirements.

### ***Regulatory risk***

Each regulation generates risk. Since the regulatory process involves two main parties: regulated entities and institution that initiates, develops and implements a regulation, termed as the regulator (for instance, the government, the parliament, the Polish Financial Supervision Authority), regulatory risk resembles a coin. On the one side, on the obverse, the regulator is placed; the regulator is responsible for the achievement of postulates or planned (anticipated) objectives of a regulation. This type of risk is termed as regulatory risk<sup>10</sup>. The regulator is almost always the strongest part, therefore regulatory risk is a very important category in the legislative process, unfortunately, in principle, unused in Poland. The regulator’s task is to determine the possibility of achieving the formulated regulatory objectives. If the probability

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<sup>10</sup> I have been interested in this issue for a long time. See, for instance, S. Kasiewicz, *Koncepcje regulacji sektora MŚP a pomiar ryzyka regulacyjnego* [in:] *Gospodarka w sieciach relacji*, ed. R. Sobiecki Wydawnictwo KUL, Lublin 2014, pp. 27–36; S. Kasiewicz, *Wpływ złożoności i ryzyka regulacyjnego na konkurencyjność sektora bankowego w Polsce* [in:] *Kryzys finansowy. Przebieg i skutki społeczno-gospodarcze w Europie Środkowej i Wschodniej*, ed. Sławomir Partycki, vol. 1, Wydawnictwo KUL, Lublin 2012, pp. 125–133.

of their achieving is low, there is no point in making efforts, employing available resources, conducting further works towards the implementation of a draft regulation. Consequently, this criterion receives the lowest score. On the other hand, when a regulation generates a low risk of failure, there are reasons to carry on this process; it implies the maximum score in the OPP model. To assess this criterion, we can measure regulatory risk: the measurement is conducted based on experts' opinions, taking account of various aspects of the regulatory process<sup>11</sup>.

### ***Enforcing the regulation***

This criterion consists in determination of the degree of the regulator's preparation to monitor and control compliance with a draft regulation. It should be assessed whether they have a plan, schemes, schedule and adequate funds and human resources to implement these actions.

The regulatory practice shows that some regulators are not aware of the fact that they are burdened with such an obligation or try to fulfill it to the smallest extent (using, for instance, simulated monitoring and control process). This situation takes place most often when a supervisory institution of a specific regulator assesses unsystematically the regulator's work in this area of activity.

## **1.4. Quantification of the principle of necessity**

In quite a common legislative practice, considered alternatives to draft regulations are not described or those descriptions are too laconic as they lack of solid arguments. Therefore it is difficult to assess explicitly whether this type of procedure, concerning legislative options, was executed. However, missing information in a report with justification for a specific regulation is alarming and indicates that authorities want to be effective only through their activity in the legislative sphere.

It seems that we should not have too high expectations in this respect. Most often the suggested analysis of an alternative action to a draft regulation is not conducted since this approach is costly, laborious and often generates new problems. A reasonable solution may be to adopt two or three options, which, in the opinion of experts, will define the limits of the regulator's decision-making area. Below is proposed a typical (hypothetical) procedure for assessing the observance of the principle of necessity, covering the assessment of seven criteria.

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<sup>11</sup> S. Kasiewicz, *Problem ryzyka regulacyjnego na tle programu "Mieszkanie dla Młodych"* (The problem of regulatory risk in connection with the program "Flat for the Young"), paper prepared for the 15th International Conference on Finance Management, Kołobrzeg 2–4 April 2014.

## Calculation procedure of observing the principle of necessity

Table 1.4 Assessing the principle of necessity

Criterion	Criterion score from 0 to 6 points
1. Alternative solutions to the regulation.	
2. Costs of alternative solutions.	
3. Benefits of alternative solutions.	
4. Regulated entities' ability to accept alternatives.	
5. Regulatory risk of alternative solutions.	
6. Type of criterion of the best alternative selection.	
7. Ability to enforce implementation of the best alternative.	

Source: prepared by the authors.

### *Alternative solutions to the regulation*

According to a common belief prevailing, particularly among the public administration, the only effective solution in this respect is to adopt a legislation (mainly in the form of an act); then, the enforcement of law will become far easier than the adoption of another form of regulation of operations of business entities. Even if we do not challenge this position, we see that the mere functioning in such a regulatory culture provides quite a big room for searching for alternative solutions. This approach may consist in examining an option that considers resignation from a regulation (*status quo*) or introduction of more or less stringent activities, by broadening or narrowing the objective or subjective scope of the regulation, for instance shortening or prolonging of the waiting period. Moreover, regulations may use to a different degree tools; for instance economic, management or psychological tools.

We should bear in mind that the regulator has a large room for selecting regulations. The applied non-statutory regulatory actions include the following actions and payments<sup>12</sup>:

- refraining from intervention, but conduct of monitoring;
- self-regulation (e.g. good practice);
- co-regulation;
- quasi-regulation;
- market impact tools:
  - taxes,
  - expenses,
  - loans and loan guarantees,
  - fees for use,
  - insurance,

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<sup>12</sup> K. Karpińska-Białek, *Ekonomiczna ocena skutków regulacji w ochronie zdrowia*, SGH Warsaw, unpublished PhD dissertation, p. 70.

- maintenance of the State property;
- information and education campaigns;
- direct product control:
  - price control,
  - quantity control – production limits,
  - determination of specific product features (technical standards, execution standards);
- input and output control;
- production process control (technical standards, execution standards);
- information control;
- marketable ownership rights.

When determining the score for this criterion, it is worth considering the following factors:

- (a) whether or not regulatory alternatives were examined;
- (b) whether or not the prevailing types of regulations with similar scope of draft problem were identified;
- (c) whether or not the analysis covered options of a given act in terms of efficiency, effectiveness and risk.

If none of these factors was the object of interest and deliberations of the regulator, then the score for this criterion is 0. If all the conditions are met, this criterion obtains the highest score.

### ***Costs of alternative solutions***

Having used the selected regulatory variants (options), an attempt should be made to estimate incurred expenditures, following the classification by direct, indirect costs, and regulatory enforcement (monitoring and control). As a result of quite laborious operations, it was possible to obtain a regulatory variant with the lowest cost. During these operations, one problem is to be solved, related to the fact that alternative regulations have a different structure of costs and, consequently, the issue of their comparability cannot be underestimated; for instance, regulatory activity in the form of a TV campaign because of the adoption of even a simple act.

Score is granted to the criterion depending on the scale of costs and precision of their measurement. If these costs are not measured, the minimum score should be granted. A low score is granted also when estimates are burdened with a very high uncertainty level. The maximum score is granted when the whole cost calculation process is characterized by the pursuit of complexity, observance of methodical rules, and a large divergence of opinions among experts.

### ***Benefits of alternative solutions***

This criterion is assessed similarly like in the previous case, related to the determination of regulatory costs. It should be mentioned that, when determining benefits, it is important to observe their distribution at a level of particular sectors of the whole economy and society (macroeconomic benefits).

The minimum score should be granted when high, non-quantified regulatory benefits are assumed a priori or when estimates are fragmentary. On the other hand, when the whole of calculations is transparent; assumptions, justifications and formulas of benefit calculations are determined, the discussed criterion can obtain a high score.

### ***Regulated entities' ability to accept alternatives***

The selection of alternative regulations should reflect such factor as perception of these regulations by key stakeholders. At this point, the regulators' attitude collides with the regulated entities. A part of this first group can be excessively optimistic with regard to the possibility of fulfilling regulatory objectives. Other part can point at a significant sensitivity to risk of failure, and other part can approach the rational character of made regulatory decisions in a too simplified way. On the other hand, the regulated entities adopt, as a rule, various policies, strategies and tactics of responding to regulations. These issues are poorly examined in the Polish conditions of managing companies and financial institutions, even in relation to statutory legislations. Based on the conducted observations, we can conclude that several regulated entities chose procedure that is based on:

- avoiding, unconsciously or consciously, adaptation to the regulation; they conclude that they will be "lucky" and will not be subjected to regulatory compliance control or conclude that it is worth paying a low penalty, which is incommensurately low as compared to regulatory costs;
- becoming specialist in regulatory evasion, by searching for regulatory weaknesses, inaccurateness, lack of supplementary legislation, using skills and experience of own or external legal units (including, for instance, regulatory arbitrage);
- pursuing the minimization of regulatory costs;
- using the regulation as a significant tool of competing and obtaining competitive advantage (it relates to relatively small groups of national companies).

It should be emphasized that entities with a positive attitude towards the best possible adjustment to the regulatory implementation change this attitude along with their growing number. It is important that a gap between the regulator's attitude towards a legislation not differ largely from the attitude of the regulated entities. If vast or prevailing part of the regulated entities accepts the chosen alternative, then this criterion can obtain the maximum score. Otherwise, the minimum score should be granted.

### ***Regulatory risk of alternative solutions***

Regardless of the assessment of costs and benefits, it is necessary to evaluate regulations alternative from the point of view of risk (exposition level = the product of probability of occurrence and effect scale). It can turn out that some of specified alternatives have highly positive net effects, however, their implementation generates a high risk. Hence it is required to assess the degree in which quality of the regulatory development, results of public consultations, availability of resources and regulatory implementation techniques affect the level of regulatory alternatives. If these types of risk are not identified and when the

measurement is not made, then 0 should be granted to this criterion. A substantive analysis of alternatives' risk enables numerical value of this criterion of 6 points to be assumed.

***Type of criterion of the best alternative selection***

When selecting the examined regulatory variants, it is important to follow their assessment criteria. Depending on the degree of information and the scope of conducted evaluation of the analyzed variants, it is possible to use measures that relate to three categories: benefits, costs and regulatory risk (criteria are presented in table 1.5).

**Table 1.5 Proposed measures for selecting variants in terms of the principle of necessity**

Type of criterion	Measure of assessment
<b>1. Qualitative</b>	
• partial	maximum benefits; minimum costs; minimum regulatory risk
• bi-dimensional	maximum benefits net (benefits minus costs); minimum costs and risk; maximum benefits and risks
• synthetic	maximum benefits net including regulatory risk
<b>2. Quantitative</b>	
<b>2.1. Static</b>	
• partial	maximum benefits; minimum costs; minimum regulatory risk
• bi-dimensional	maximum benefits net (benefits minus costs); minimum costs and regulatory risk; maximum benefits and regulatory risks
• synthetic	maximum benefits net including regulatory risk
<b>2.2. Dynamic</b>	
• partial	maximum benefits; minimum costs; minimum regulatory risk
• bi-dimensional	maximum benefits net (benefits minus costs); minimum costs and risk; maximum benefits and risk
• synthetic	maximum benefits net including regulatory risk

Source: prepared by the author.

Qualitative measures result from an assessment conducted by experts, on the other hand quantitative measures are built on the basis of gathered data, made estimates and obtained information. They can relate to one effective term of the regulation, excluding changes over time. At that time, they are static. Contrary to them, dynamic measures include the factor of time.

### ***Ability to enforce implementation of the best alternative***

A weakness of new regulations implemented in the economic practice is the lack of complex control and monitoring system. Unfortunately, this practice is common in Poland. It seems that this approach cannot be maintained in the long run since it involves too high costs for the economy and society. Therefore, the regulation being implemented into the practice of economic life should be accompanied by a document that indicates an effective system for monitoring and controlling regulatory impact assessment.

The minimum score is granted to this criterion in the cases when a regulation is accepted but without an element that indicates its enforceability. The better the planning of the implementation discipline, the higher the level of assessment of this regulation.

### **1.5. Quantification of the principle of proportionality *sensu stricto***

The quantification of the principle of proportionality may be conducted in two extreme versions: simplified and full. In the first version, entities that analyze the principle of proportionality try to justify the scoring of various dimensions of the principle of proportionality *sensu stricto* (table 1.6). On the other hand, full quantification of the principle of proportionality requires a quantitative analysis in monetary units of each significant dimension of the principle of proportionality *sensu stricto*.

#### **Calculation procedure of observing the principle of proportionality *sensu stricto***

##### **Simplified version**

Table 1.6 Assessing the observance of the principle of proportionality *sensu stricto*

<b>Criterion</b>	<b>Criterion score from 0 to 6 points</b>
1. Macroeconomic proportionality	
2. Functional proportionality	
3. Sector proportionality	
4. Proportionality by stakeholders	

Sources: prepared by the authors.

##### ***Macroeconomic proportionality***

This element of the regulatory impact assessment is the most important. It consists in determination of the degree in which the analyzed document affects social well-being, which can be defined on various bases (GDP, social consumption, broadly understood investments, safety, stability)<sup>13</sup>. If a legislation being assessed has no positive impact on social well-being,

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<sup>13</sup> See C. Furtado, *Mit wzrostu gospodarczego*, Warsaw 1978; L. Zienkowski, *Poziom życia. Metody mierzenia i oceny*, Warsaw 1979; S. Sztaba, *Ekonomia niekonwencjonalna*, Warsaw 1993; J. Drewnowski, W. Scott, *The Level of Living Index*, Geneva 1966; J. Drewnowski, *Studies in the Measurement of Level of Living and Welfare*, Geneva 1970; *List of Social Concerns, Common to Most OECD Countries — The OECD Social Indication Development*

it obtains the minimum score, namely 0. If its impact is significant and positive, it obtains the maximum score.

### ***Functional proportionality***

It is also purposeful to assess the observance of the principle of proportionality in functional terms, referring to key areas of impact of a specific regulation; namely economic, social and ecological area. If it relates only to fulfilling objectives from one area or its impact is prevailing, it should be concluded that we cannot refer to the observance of the principle of proportionality *sensu stricto*. A signal of such an assessment may be a result of social consultations, especially of key stakeholders. If representatives of social stakeholders, e.g. customers, local governments, trade unions, indicate a significant negative regulatory impact on their attitudes, positions and economic consequences, than a specific regulation should obtain the minimum score. The greater the degree of a reasonable compromise between interests of groups of stakeholders, the greater the degree of the observance of the principle of proportionality *sensu stricto*.

### ***Sector proportionality***

The sector dimension of the principle of proportionality *sensu stricto* refers to assessing the degree of regulatory impact on three problem areas related to responding, provided that:

- the regulation fosters achievement of the adopted economic policy objectives;
- the regulation fosters development of other sectors, including other entities;
- the regulation creates development conditions, in particular for SMEs

When regulations do not contribute to the implementation of the economic policy of the government, they inhibit largely the development of other economic sectors. Thus they can be classified as development barriers, in particular for SMEs. In this case, the minimum score should be granted to a specific regulation. In the case of highly positive potential regulatory impact on these problem areas it is justified to grant the maximum score to this criterion.

### ***Proportionality by stakeholders***

As it has been emphasized many times, each regulation has its beneficiaries and losers, who incur additional costs or face a higher level of risk with regard to running profitable business operations. Therefore it is not desired that only one, narrow group of stakeholders, for instance only customers, obtain disproportionately high benefits. In our opinion, it makes other stakeholders take in the short run actions aimed at compensating their “harm” or “regulatory injustice” with regard to equal rules of competition on the market. The list of possible methods of responding is very long and, more importantly, usually these actions are not anticipated by regulators and supervisors. In fact, it makes net benefits of regulations much lower than planned or forecasted. From this point of view, it is important to conduct marketing campaigns with clearly stressed indications in favor for introducing a regulation. Actions should refer to the fallibility of the market mechanism and an insufficient level of fulfilling objectives of the government’s economic policy so that key stakeholders realize their presence. Moreover, it

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*Programme nr 1, Paris 1973; E. de Leon, National Indicators and Social Wealth, CPS Urban Institute, December 2012.*

should be aimed at achieving a clear compromise between stakeholders, by showing regulatory benefits that can be ignored, unnoticed or interpreted inadequately.

Therefore, extreme disproportions in benefits, costs and risk between stakeholders, resulting from a given regulation indicate that this criterion should obtain the minimum score. Higher consensus among key stakeholders involves higher score in the OPP model.

### **Version of a full or extended quantification**

We are convinced that the principle of proportionality will be evolving towards increasing quantification, where each criterion of proportionality *sensu stricto* will obtain more developed, more complex model depiction and will fulfill to a greater degree the pursuit of expressing the obtained results in monetary units. Thus decisions on the observance of the principle of proportionality can be made on the basis of unambiguous calculation results. At this point, statistical, econometric, simulation or experimental methods can be applied. It seems that the current state of progress in determining the degree of observance of the principle of proportionality does not enable a more complex and useful methodology to be applied. It requires testing a significant number of legislations, obtaining greater experience and building tools along with adequate databases. Moreover, it should be mentioned that for this purpose quite successful attempts are made, an example of which is the publication *Wpływ regulacji sektora bankowego na wzrost gospodarczy – wnioski dla Polski (Banking Sector's Regulatory Impact on the Economic Growth; Conclusions for Poland)*<sup>14</sup>.

### **Conclusions**

To sum up these deliberations, we believe that, although the OPP model is at quite an embryo stage of development, it has several positive features, including but not limited to:

- it combines qualitative and quantitative assessment in the simplest possible way;
- it is a flexible method, independent of the type of regulation; it enables various criteria to be applied, depending on the specific character of the area covered by a regulation. Moreover, it includes management aspects, motivational aspects, attitudes and behaviors of stakeholders;
- it permits unambiguous selection of regulations (regulations to be adopted or rejected, issues to be amended);
- it is more realistic than key regulatory impact assessment methods, namely cost-benefit analysis, regulatory impact assessment;
- it indicates main advantages and disadvantages of the specific regulation;
- it may be an useful or even necessary supplementation of key regulatory impact assessment methods;
- it indicates possible directions of legislative process coordination;
- it has a large methodological development potential.

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<sup>14</sup> M. Marcinkowska, P. Wdowiński, S. Flejterski, S. Bukowski, M. Zygierewicz, *Wpływ regulacji sektora bankowego na wzrost gospodarczy – wnioski dla Polski*, "Materiały i Studia" No. 305, NBP, Warsaw 2014.