Regulatory reform & innovation

Innovation falters when regulation doesn't lead tech but follows it

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The last few decades of human civilisation have been the most significant in terms of technological progress.. The rapid advances of sciences is resulting in a snow-balling effect on innovation across disciplines. The advent of new technologies — gene-editing, artificial intelligence, blockchain, to name just a few — are revolutionising human-technology interaction. Further, innovative business models centred around the sharing economy (for instance, ride-hailing services, short-term apartment-renting etc.) are on course to make established business models redundant.

In the backdrop of the shifts across industries, a recurring question before regulators is, how should they respond to innovation? The answer to that question and the consequent approach may have lasting impact on the socio-economic trajectory of an economy.

Regulators have traditionally been technology-laggards, that is, regulations tend to follow advances in technology rather than lead them. There is typically a time-lag of a couple of years before advances are formally recognised and provided for in a regulatory framework. This lag has at least two consequences that adversely affect innovation — the prospect of initial regulatory uncertainty may disincentivise innovation in the first place from a perspective of potential regulatory-acceptance of innovation; second, by the time an innovation receives regulatory recognition it might already be past its 'innovative prime' and hence the full-potential of an innovation could not be optimally harnessed resulting in potential inefficiency. These externalities have the potential to inhibit innovation in the first instance by enhancing transaction costs that ultimately decrease their social utility.

It is important for policy makers to recognise the role legal systems may play in enabling and fostering innovation. For example, by virtue of the legal authority vested in them, regulators have the potential to internalise the above conditions by providing timely and appropriate recognition to new technologies in the regulatory framework. An early-recognition triggers a series of positive effects for an economy, for instance, academic curriculum incorporates such advances leading to trained manpower who in turn engage in high-value activities leading to enhanced productivity which ultimately results in economic development.

An accommodative approach of the regulator signals two messages — first, it provides due recognition to an otherwise new technology which might lack a legal recognition within the existing regulatory framework; second, it creates the right environment for technologists to keep innovating as they will find a new partner in the regulator who will enable new technologies to come to life.

The next logical question is, how can regulators develop the capacity to fulfill this role? Regulators need to tap into the talent pool of the private sector to build initial in-house capabilities. For the long term, they should focus to remain current and build capacity through training and exposure to cutting-edge technologies.

Regulatory inertia to the 'new' or the 'next' requires a rethink. This becomes even more important in a connected global economy where increased mobility of factors of production means greater competition among regulators in different geographies to attract them.

The fluidity of innovation makes it all the more escapable to a jurisdiction which harbors and promotes it. In a rapidly evolving world, regulatory agility is not only a need but also a competitive advantage. An innovation-biased regulatory approach might in some instances lead to race to the bottom, and in some cases it might not work out in the manner it was supposed to, but it is still worth the risk for an economy to hop on the innovation bus for otherwise it might just become obsolete.

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