

# Reducing the business costs of regulation\*

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A couple of weeks ago it was reported in the press that an international survey of businessmen had apparently detected considerably more disquiet about the impact of government regulation on their businesses than about the impact of a war with Iraq.

Here in Australia, the complexity of government regulations, and the costs of business compliance, were among the ten most important issues nominated by small business in an Australian Chamber of Commerce (ACCI) survey conducted prior to the 2001 Federal election. Respondents to ACCI's quarterly *Survey of Investor Confidence* consistently nominate government charges and business taxes as major factors constraining business investment.

It seems clear that business, whether big or small, has grievances with government regulations and charges, and those who administer them. Are they justified? What is being done about these issues? What more should be done? These are some of the questions that I will try to answer in this brief address.

## **Business faces extensive regulation**

A useful place to begin might be to briefly map the regulatory landscape. In Australia today there are some 60 Commonwealth departments and agencies involved in making and administering regulations. There are a further 40 Ministerial Councils and national standard setting bodies directly involved in regulatory issues. Each State and Territory Government has its own similar range of regulatory departments and agencies. And the myriad of local councils have a major role in land planning, development, traffic and certain public health matters.

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### *Many faces of regulation*

This institutional diversity is compounded by the hydra-like nature of 'regulation' itself. Regulations impacting on business take various forms. These include, at the highest level, Acts of Parliament. They also include subordinate legislation, where the Parliament delegates powers to a Minister, board or organisation. But regulation can also include codes, instruments and standards which governments use to influence business behaviour, but which do not involve 'black letter' law (known as 'quasi regulation'). And of course there are also various international treaties which impact on business, either directly or indirectly.

### *Rising volume of regulation*

Measuring the volume of all this regulation, or even just the flow of new or amended regulation, is not straightforward. There are only partial indicators available. For example, the Attorney General's Department estimates that there are more than 1800 Commonwealth Acts currently in force. Last year around 170 new Commonwealth acts were promulgated. This is comparable to legislative activity during the 1980s and 1990s, but well above that in earlier decades.

More tellingly, there has been a steady increase in the average *length* of legislation. Nearly 55,000 pages of legislation were passed by the Commonwealth Parliament in the 1990s, equivalent to around 30 pages per Act on average. This was about twice the page count for Acts passed in the 1980s and almost three times that for the 1970s.

The stock of other less 'visible' types of regulation has also increased over the last couple of decades. Unfortunately there is not (yet) a consolidated and comprehensive register of all subordinate instruments. However, information on the number of statutory rules and disallowable instruments (those subject to parliamentary scrutiny) reveals that more than 7 200 such regulations were made in the five year period 1997-98 to 2001-02. The good news is that this was about 2000 less than the total number of regulations made in the previous five year period. But it was still well above the level of regulatory activity in the mid to late 1980s.

I have only been talking about trends in *Commonwealth* legislation. State/Territory and local government regulation often impacts more directly on the activities of firms. Its growth and its compliance costs may well be higher than at the Commonwealth level.

In sum, regulation could almost be regarded as a growth industry in itself, with a significant proportion of this growth not being subject to direct scrutiny by the Parliament.

### **How much regulation do we *need*?**

Regulations are essential for a properly functioning society and economy. They shape incentives and influence how people behave and interact, and can help societies deal with otherwise intractable economic, social and environmental problems. At their best, regulations create order and provide a basis for stable progress.

#### *Characteristics of 'good' regulation*

But regulation can be good or bad. To be 'good', regulation must not only bring net benefits to society, it must also:

- be the most effective way of addressing an identified problem; and
- impose the least possible burden on those regulated and on the broader community.

To meet these tests, regulation needs to exhibit some important design features:

*Regulation should not be unduly prescriptive.* Where possible, it should be specified in terms of performance goals or outcomes. It should be flexible enough to accommodate different or changing circumstances, and to enable businesses and households to choose the most cost effective ways of complying.

*Regulation should be clear and concise.* It should also be communicated effectively and be readily accessible to those affected by it. Not only should people be able to find out what regulations apply to them, the regulations themselves must be capable of being readily understood.

*Regulation should be consistent* with other laws, agreements and international obligations. Inconsistency can create division, confusion and waste.

*Regulation must be enforceable.* But it should embody incentives or disciplines no greater than are needed for reasonable enforcement, and involve adequate resources for the purpose.

Finally, regulation needs to be *administered by accountable bodies* in a fair and consistent manner, and it should be *monitored and periodically reviewed* to ensure that it continues to achieve its aims.

## **The issue of compliance costs**

Over the last decade or so there has been a growing realisation that much regulation impacting on business has failed such tests. Various reviews have revealed a common reason for this failure: a tendency by governments to be mainly concerned with the benefits of regulation to particular groups, without giving enough consideration to the costs.

A particular concern for business has been the costs of complying with the many regulations that affect them. However there is limited empirical data to enable a consistent assessment of compliance costs, especially over time.

### *Some key studies*

In a major recent international study, the Organisation for Economic Cooperation and Development (OECD) — with the assistance of an ACCI survey — estimated that taxation, employment and environmental regulations imposed over \$17 billion in direct compliance costs on small and medium sized businesses in Australia in 1998. Of these costs:

- employment regulations accounted for 40 per cent (OECD average was 35 per cent);
- compliance with tax regulations accounted for 36 per cent of the total (the OECD average was 46 per cent); and
- environmental regulations accounted for 24 per cent (OECD average was 19 per cent).

The OECD estimated from the survey that Australian SMEs incurred compliance costs averaging \$33 000 annually — a large number, but still a bit under the OECD average of \$36 300.

An earlier survey of small business (excluding medium sized businesses in the OECD survey) conducted for the Commonwealth Government's Small Business Deregulation Taskforce (1996) found that on average small business spent 16 hours a week on administration and compliance activities. Of this, government paperwork and compliance accounted for, on average, around four hours per week. Taxation matters absorbed three of these hours and one was spent on other activities. Total compliance costs were estimated to be \$7000 a year. Of this, \$3000 was spent on external advice.

The disparity between the local study's results and those of the OECD can be partially explained by the former's focus on 'small business' as well as a narrower definition of costs (for example, excluding capital expenditures).

However, a significant difference remains, which reflects inherent problems in survey-based assessments of such issues.

The attempt by the Small Business Deregulation Taskforce to quantify the extent of the overall administrative burden on small business represents the only currently available domestic study. While the taskforce recommended that a future study be undertaken, this has still not been acted on. So there is no empirical basis for evaluating progress in reducing the costs of ‘red tape’.

### *Small business issues and impacts*

It is an established fact that the burden of regulation falls more heavily on small businesses; not because they are more heavily regulated, but because they have the least capacity to cope.

Operators or managers of smaller businesses are less likely to have specialist staff with detailed knowledge of regulations or taxation matters. Regulations are more likely to be dealt with by prime decision-makers, distracting them from their core role. The costs of such managerial diversion are very difficult to assess, but are potentially large.

The Small Business Deregulation Taskforce found that, among other things:

- small businesses often do not understand their compliance obligations;
- unnecessary delays in processing and approvals, and duplication of information requirements, were resulting in lost time; and
- inconsistency in administrative interpretation can result in uncertainty about processes and outcomes, which impact adversely on business confidence.

Indeed, many firms have indicated that they regard the behaviour of the regulators and administrators as being of as much concern as the regulations themselves. This was confirmed in the OECD study, in which Australian businesses expressed particular dissatisfaction with a lack of consultation, the perceived lack of consistency in regulatory decisions and the appeals and complaints processes.

Achieving consistency in the design of forms, “business friendly” contact points and having helpful (and capable) officials handling inquiries can all help. But there are larger questions about regulatory accountability that deserve more attention. These have to do with the clarity and extent of delegated powers, the transparency of decision-making, and rights of appeal and review. (These are important issues, which my organisation has addressed in some recent inquiries and will continue to look into, but they are not the main focus of this address.)

## **Recent reform initiatives**

While it may be cold comfort, the international comparisons reveal that Australian businesses are by no means alone in bearing a significant regulatory burden. We also need to acknowledge that Australian governments have undertaken some important regulatory reform initiatives in recent years.

These include, at the Commonwealth level, initiatives flowing from the Small Business Deregulation Taskforce, including most notably the upgrading of regulation impact requirements where business is affected. A number of the States have similarly made moves to reduce regulation and expose new regulation to greater scrutiny at the development stage.

### *NCP Reviews*

Under the 1995 inter-governmental agreement to implement the NCP, some 1,800 reviews of legislation impacting on competition have been carried out since 1996. There is evidence that at least some of the resulting reforms have streamlined and simplified regulatory requirements, or resulted in greater harmonisation between jurisdictions.

### *COAG Principles and Guidelines*

Since 1995, Ministerial Councils and national standard-setting bodies have had to comply with COAG requirements when making regulations. Apart from subjecting new regulation to more rigorous vetting processes, these enshrine the principles of ‘minimum necessary regulation’ and performance-based flexibility.

### *Mutual recognition*

Australian governments implemented ‘mutual recognition’ legislation in 1993. This was extended to trade with New Zealand in 1998 with the passage of the Trans Tasman Mutual Recognition legislation.

Mutual recognition has been a very important initiative. It essentially allows for the side-stepping of regulatory hurdles to trade in goods and services by:

- removing the need for goods sold in one jurisdiction to comply with different regulatory regimes in other jurisdictions; and
- removing the need for persons in regulated occupations having to comply with different occupational entry requirements for other jurisdictions in which they wish to operate.

How well these arrangements have worked in practice is currently under review by the Productivity Commission, at the request of heads of Government. However such arrangements clearly do not obviate the need for all governments to be vigilant in ensuring that new regulations are well designed in the first place.

In particular, it is critical that compliance costs, as well as other costs and benefits associated with regulatory proposals, are identified and analysed as early as possible in the policy development process. In most jurisdictions there are systems in place to facilitate this, but their potential has yet to be realised.

## **The value of RISs**

Among the more important government initiatives of recent years have been those which require the use of regulation impact statements (RISs) in the developmental phase of regulation.

The RIS process requires policy makers to consult, and to work through a sequential process of articulating the problem potentially requiring regulation, to assess a range of options, recommend the best option and explain why other options — including non-regulatory ones — are not as good. Taken together, these elements constitute a best-practice process designed to produce ‘good’ regulation. In particular, the process seeks to move agencies away from the traditional ‘regulate-first’ approach.

### **Box 1.1 Regulation Impact Statements**

Regulation Impact Statements (RISs) are often required for regulation that has an impact on business. But they have wider applicability, as they simply document a sound policy development process, comprising the following elements:

- identification of the *problem* requiring action and the desired *objective* or outcome;
- setting out the *options* (regulatory and non-regulatory) and their respective *costs and benefits* across the economy and community;
- *consultation* with those potentially affected; and
- a strategy to *implement* and *review* the preferred option.

A critical feature of this process is that RISs are required to be presented to political decision-makers in time to inform their decisions. The RIS must also accompany bills and subordinate legislation into Parliament, enhancing the scope for a well-informed political debate, and providing transparent accountability to the community.

The Office of Regulation Review (ORR), which is part of the Productivity Commission and shares its statutory independence, is the Commonwealth government's watchdog over this regulation review process (it also serves a similar role for COAG in relation to national regulatory proposals).

There is a particular emphasis on small business in the requirements on Commonwealth agencies. To quote from the Cabinet-endorsed *A Guide to Regulation*:

The Government has asked the ORR to ensure that particular effects on small businesses of proposed new and amended legislation and any other regulation are made explicit in the RIS. The RIS should also give full consideration to the Government's objective ... of minimising the paperwork and regulatory burden on small business.

Adequacy criteria for RISs set out in that publication include the following requirements:

- that regulators 'determine which groups are likely to experience these benefits and costs and what the extent of their impacts are likely to be';
- that 'the impact of a regulation on ... small business ... should be identified'; and
- that 'a comprehensive assessment of each option's expected impact is prepared'.

In assessing costs, 'RISs should include estimates of both one-off and ongoing compliance costs.' In addition 'ways to minimise compliance and paper burden costs should be discussed'.

#### *Regulatory performance measures and regulatory plans*

There are other requirements at the Commonwealth level which deserve mention. With the help of the ORR, the Office of Small Business collects and publishes data against indicators of good regulatory practice. They have been designed as a first step towards enabling benchmarking of government performance in regulatory reform. One of the nine indicators relates to the proportion of regulations for which the relevant RIS adequately justified the compliance burden on business.

In addition, there is a requirement at the Commonwealth level for formal 'Regulatory Plans', whereby agencies must record their previous year's regulatory activity and, more importantly, their intentions for the year ahead. The purpose of the annual Regulatory Plan is to alert stakeholders to upcoming regulatory reviews and changes and, in the longer term, bring a strategic focus to the activities of these agencies. This initiative is designed to improve the

transparency of regulation making and put pressure on agencies to make greater use of RISs early in policy development.

## **Compliance of regulators with the RIS requirements**

Clearly there are now systems in place to promote good regulation-making at the Commonwealth level. How well are they serving the (business) community? The short answer is ‘reasonably well, but plenty of room for improvement.’

Of the 145 RISs required in 2001-02, 130 had been prepared for the decision-maker and, of those, 128 were judged to be of an ‘adequate’ standard. This translates to a RIS compliance rate at the crucial decision-making stage of 88 per cent. This represents a significant improvement over earlier years.

However, it is of concern that compliance has tended to be poorest where it matters most. Last year the ORR ranked RISs according to the perceived economic and/or social significance of the regulations concerned. It found that compliance at the decision-making stage was only 70 per cent for the 10 regulatory proposals with the most significant impacts on business or the community.

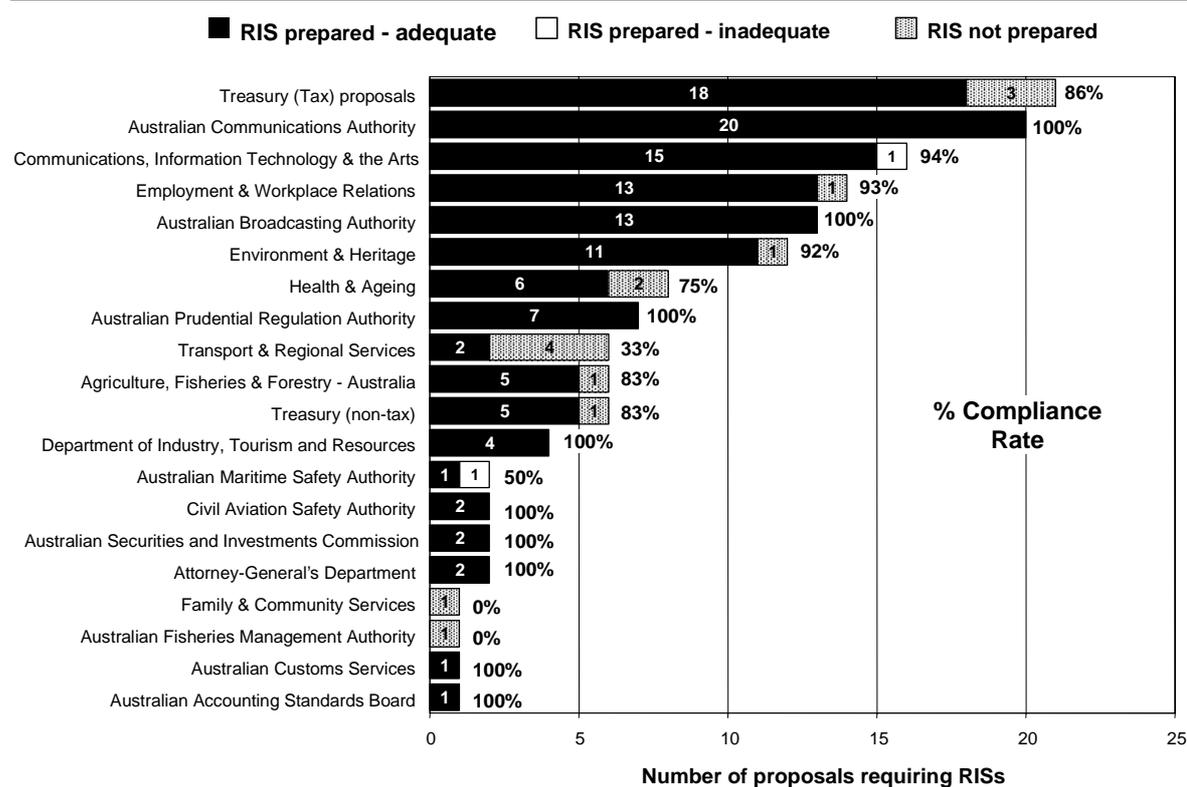
Such regulatory actions also tend to be the most ‘political’ or urgent. Departments sometimes argue that there is no time in such situations to follow the RIS processes; that the RIS ‘gets in the way’. However it is precisely in such situations, where governments are under great pressure to ‘do something’ and do it quickly (such as in areas like public liability or medical indemnity insurance) that good process is needed to ensure that the potential costs, as well as benefits of proposed regulation are given adequate consideration. Timeliness should not preclude good process.

Some government departments and agencies can clearly do a lot better. As can be seen from the following chart, RIS compliance varied considerably in 2001-02. Indeed, for the major policy-making portfolios, compliance rates ranged from zero to 100 per cent!

RISs which fail to meet minimum standards, usually display the following characteristics:

- poor definition of problems and objectives;
- inadequate consideration of alternative options;
- incomplete cost/benefit assessments; and
- inadequate consultation with those affected.

## RIS compliance is variable<sup>a,b</sup>



<sup>a</sup> At the decision-making stage, 2001-02 <sup>b</sup> The Department of the Treasury is counted twice, to separately identify tax RISs which are usually prepared in consultation with the Australian Taxation Office.

There is also considerable scope for improvement in the *timing* of RISs. If they are to assist decision-making, RISs need to be prepared early in the policy-development process. In too many cases they are being hurriedly prepared after policy decisions have effectively already been made. In those circumstances, the RIS becomes little more than ex-post rationalisation. Its content may end up being adequate, but it is unlikely to make a useful contribution to policy development.

Timeliness in preparation of a RIS is also important to the quality of the analysis contained in it. Many of the RISs that were eventually assessed as adequate by the ORR required a lot of work and a number of revisions to get them over the line. The relatively high overall 'pass rate' in 2001-02 is in part a reflection of the effort that the ORR puts into assisting departments and agencies throughout the year (often against excessively tight time frames).

In principle, the early identification and assessment of regulatory proposals should have been facilitated by the requirement for 'regulatory plans' (mentioned previously). In practice, the compliance of regulators with this sensible requirement has been patchy, with such plans being hard to find or not available at all.

## *RISs and compliance costs*

On the key issue of the compliance costs of regulatory and tax proposals, RISs typically contain a relatively brief qualitative assessment. Only about 30 per cent of RISs considered by the ORR also contain *quantitative* assessments, which include estimates of the number of businesses affected or the likely financial cost per business.

In practice measuring compliance costs is not a simple task. At this point in time, there is no generally agreed methodology, although progress is being made on a number of fronts, including work by the OECD. In its current review of compliance and administrative costs incurred by doctors in general practice, the Commission has identified ways of better measuring such costs. Summing the outlays on equipment and systems and the time costs of the people involved, the Commission estimated these costs at some \$230 million at the Commonwealth level. In principle, we should also include the intangible costs — notably frustration and stress — that we have been told about, but those are particularly difficult to estimate.

The fact the Commission was given this task by Government indicates that there is growing recognition of the need to better account for compliance costs in regulation-making. As noted, this was reflected in the Government's response to the report of the Small Business Deregulation Taskforce. Most recently, the report into small business employment, by the Senate Employment, Workplace Relations and Education References Committee has recommended that work be undertaken to better measure such costs.

The reality is that, in many cases, departments and agencies appear not to have sufficient internal expertise to adequately perform an assessment. This is not an insurmountable problem in itself. But there also appears to be a lack of recognition of the importance of considering compliance cost burdens associated with new or amended regulation. These problems were highlighted in the Small Business Coalition's pre-budget submission. I find it hard to disagree with the conclusion in that document that:

There are large cultural barriers within certain Federal Departments and Agencies ... that need addressing.

While Australia has generally been at the forefront internationally in instituting 'quality control systems' for regulation, this has so far not extended to assessments of compliance costs.

In countries such as the United States, United Kingdom and New Zealand, departments and agencies routinely provide considered assessments of regulatory compliance costs in RISs.

The ORR has recognised this deficiency and has been attempting to raise the standards in Australia through its training programs for officials, and by requiring a greater level of analysis about compliance costs in RISs before they can be assessed as adequate.

### *Cost recovery by regulators*

Many businesses see regulatory agencies as adding insult to injury by imposing a regulatory burden on them and then charging them for the privilege. In its recent review of agencies' cost recovery practices, the Productivity Commission found them to be ad hoc and opaque, with poor accountability and review mechanisms. The Commission found legitimate reasons for some cost recovery, but recommended that all such measures be tested against formal guidelines which require them to have a sound economic rationale (rather than simply a revenue-raising objective). The Government has now released such guidelines, including a requirement to bring any proposed regulation with a cost-recovery dimension within the RIS framework.

### **Following through**

Looked at in the broad, it is apparent that regulatory reform over the last decade has achieved a great deal. Regulations are now often explicitly pro-competitive and outcome focused. And there is growing evidence that this has paid off in Australia's relatively strong economic performance.

However, it is equally clear that more needs to be done at the detailed level to improve the quality of regulations and, in particular, to reduce compliance costs. Notwithstanding the initiatives implemented in recent years, Australian governments can do more to ensure that regulations do not impose unnecessary costs on business and the community.

At the Commonwealth level, the necessary procedural infrastructure is now largely in place, at least for the sorts of regulation that get Parliamentary scrutiny. It simply needs to be better utilised, especially for more significant or contentious regulatory initiatives. The exposure of detailed information about the compliance of individual departments and agencies with the RIS process may already be concentrating bureaucratic minds in this respect.

Processes within the States and Territories suffer from being more limited in coverage and from not having independent status for their review bodies. However, a number of States do better than the Commonwealth when it comes to subjecting subordinate or delegated legislation to RIS-type disciplines and exposure. The Commonwealth has identified a need to get better procedures for

the making of such regulation, but has struggled to make headway. Since 1994 various bills have been prepared, but have been blocked in the Senate. The Government is currently preparing a revised bill for the Parliament.

An essential complement to more rigorous processes for making new regulation is the periodic review of existing regulation — particularly that which may impose substantial adverse impacts on business (or indeed other sections of the community). There is an advantage in having such reviews conducted at arms-length from the government bureaucracy, to enable a fresh and independent assessment. This is the Productivity Commission's niche and it has been active in this area. Its current work program includes reviews of such key areas of regulation as the TCF assistance regime, GP redtape, disability discrimination laws, native vegetation regulation and workers' compensation/OH&S. In all such reviews, the Commission seeks to find ways of meeting regulatory objectives in ways that take account of all the costs as well as the benefits.

Further progress in reducing the business costs of regulation will not only require the diligence and commitment of governments, it will also need the active support of business. It must be said that such support is not always forthcoming. For example, the Commission's attempts to assess the costs of red tape for medical practitioners has been impeded by GPs' unwillingness to provide the information (which only they can do). And, while business has expressed concerns about government cost recovery practices — and the ACCI was instrumental in getting the Productivity Commission inquiry into these — another key business lobby neglected that important opportunity to participate and press its own views on this matter.

At the end of the day, regulation is unavoidable and indeed much of it is desirable. Some compliance costs, unfortunately, are also inevitable — they represent the price of the benefits which regulation brings. The trick is to get the balance right. That will require continued effort and vigilance by both governments and business.

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