

Improving Australia's business environment through good regulatory process¹

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Australia has undergone sweeping structural reforms over the past two decades that have helped transform its economic performance. The reforms included initiatives to ensure good regulatory process, most notably the Regulation Impact Statement (RIS) requirements. However, the RIS process has not yet realised its full potential. Business groups remain concerned about the growing volume of regulation and its effects, particularly compliance costs.

In October 2005, the Australian Government established the Regulation Taskforce to identify actions to improve regulation and in April 2006 agreed to many of the recommendations made by the Taskforce. The Government reaffirmed its commitment to improving the business environment by strengthening its requirements for good regulatory process. The initiatives are aimed at embedding the RIS process into the policy development process for all regulations that are likely to affect business. They include employing rigorous cost-benefit analysis and, where appropriate, incorporating risk analysis, quantifying compliance costs and strengthening consultation requirements. These initiatives may be of interest to Korea.

¹ Paper presented at the International Conference of Korea Development Institute, *Regulatory Reform to Improve Business Environment in Korea*, Seoul, 4 May 2006.

Introduction

Australia has a federal system with three tiers of government – Commonwealth, States/Territories and local. As a consequence, the regulatory landscape in Australia is complex. There are some 50 Australian Government departments and agencies involved in making and administering regulations. There are a further 50 Ministerial Councils and national standard-setting bodies directly involved in regulatory issues. Each State and Territory Government also has a 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.

Australia has undergone sweeping structural reforms over the past two decades that have helped transform its economic performance. In the broad, these reforms have typically involved improving growth by removing policy related distortions and impediments to a well-functioning market economy. In essence, the reforms freed up markets, promoted competition and generally sought to ensure that prices did their job of signalling costs and relative returns (box 1).

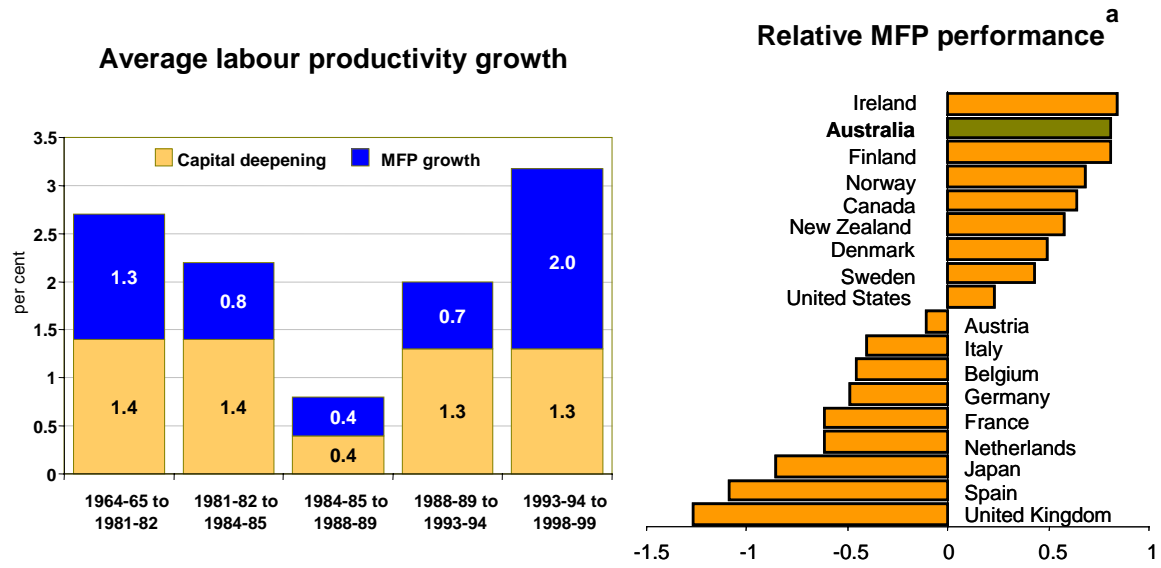
Impacts of these reforms

With the broad range of reforms, Australia experienced a surge in multifactor productivity performance (MFP) growth during the 1990s, averaging almost 2 per cent, more than double its previous rate (figure 1). Australia's MFP performance was among the best in the OECD and its labour productivity growth exceeded that of the United States.

Accompanied by rising labour utilisation, this translated into annual growth in per capita incomes of around 2.5 per cent in the 1990s, well above the previous average and that for the OECD as a whole (1.7 per cent). As a consequence, Australia has seen its position on the international per capita GDP scale rise again from 15th to 8th over the past decade or so (figure 2). It is sobering for Australians to consider where we might be today had we kept our prior course.

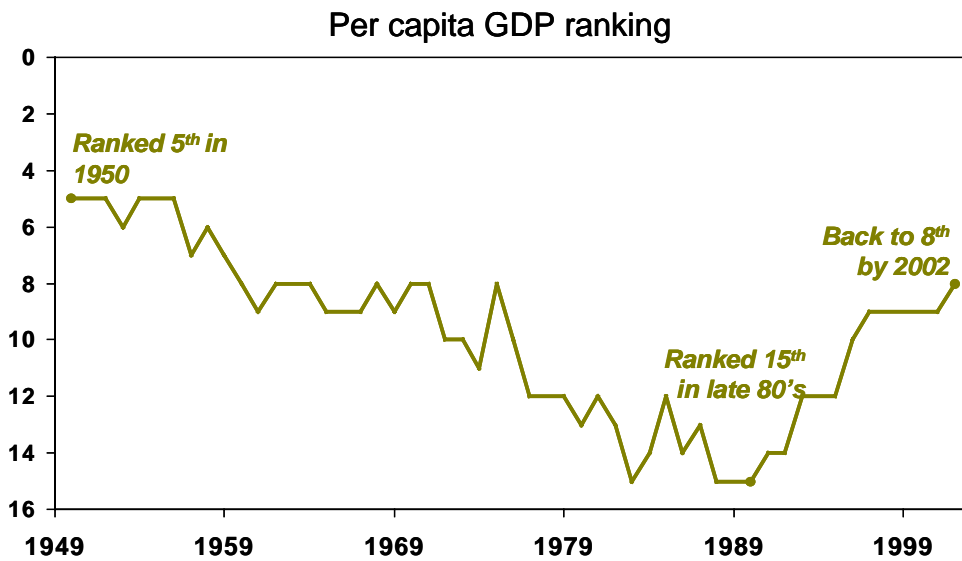
While many initiatives contributed to better economic performance, improvements in regulation played a significant part. The remainder of this paper examines the characteristics of good regulation and developments associated with the Australian Government's requirements for good regulatory process.

Figure 1 Australia's productivity turnaround



^a Percentage points change to average annual MFP growth 1980-1990 to 1990-2000. Korean estimates not available. *Source: Banks (2005).*

Figure 2 Fall and rise of Australia's economic ranking



Box 1 Two decades of economic reform

Trade liberalisation – reductions in tariff assistance (that began in 1972) and the abolition of quantitative import controls – mainly in the automotive, whitegoods and textile, clothing and footwear industries – gathered pace from the mid 1980s. The effective rate of assistance to manufacturing fell from around 35 per cent in the early 1970s to 5 per cent by 2000.

Capital markets – the Australian dollar was floated in March 1983, foreign exchange controls and capital rationing (through investment controls) were removed progressively from the early 1980s and foreign-owned banks were allowed to compete – initially for corporate customers and then, in the 1990s, to act as deposit taking institutions.

Infrastructure – partial deregulation and restructuring of airlines, coastal shipping, telecommunications and the waterfront occurred from the late 1980s. Across-the-board commercialisation, corporatisation and privatisation initiatives for government business enterprises were progressively implemented from around the same time.

Labour markets – the Prices and Incomes Accord operated from 1983 to 1996. Award restructuring and simplification, and the shift from centralised wage fixing to enterprise bargaining, began in the late 1980s. Reform accelerated in the mid 1990s with the introduction of the Workplace Relations Act 1996, further award simplification (through limited prescribed employment conditions in enterprise bargaining agreements) and the introduction of individual employment contracts (Australian Workplace Agreements).

Human Services – competitive tendering and contracting out, performance-based funding and user charges were introduced in the late 1980s and extended in scope during the 1990s; administrative reforms (for example, financial management and program budgeting) were introduced in health, education and community services in the early 1990s.

'National Competition Policy' reforms – In 1995, further broad ranging reforms to essential services (including energy and road transport), government businesses and anti-competitive regulation was commenced by all Australian governments through a coordinated national program.

Macroeconomic policy – inflation targeting was introduced in 1993. From the mid 1980s, fiscal policy targeted higher national saving (and lower current account deficit) and, from the mid 1990s, concentrated on reducing government debt, primarily financed through asset sales (privatisation).

Taxation reform – capital gains tax and the dividend imputation system were introduced in 1985 and 1987, respectively. The company tax rate was lowered progressively from the late 1980s. A broad-based consumption tax (GST) was implemented in 2000, replacing the narrow wholesales tax system and a range of inefficient state-based duties. And income tax rates were lowered at the same time.

Source: Banks (2005).

Characteristics of good regulation

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.

While poor regulation can be reformed, the task can be a challenging one. Once regulations are in place, expectations and interests settle around them. Change can be disruptive and it can strongly resisted by interested parties – including regulators themselves.

The challenge for government is to deliver effective and efficient regulation – regulation that is *effective* in addressing an identified problem and *efficient* in terms of minimising compliance and other costs on the community.

Regulations that conform to best practice design standards are characterised by the following principles and features:

- Minimum necessary to achieve objectives
 - Overall benefits to the community justify the costs
 - Kept simple to avoid unnecessary restrictions
 - Targeted at the problem to achieve the objectives
 - Not imposing an unnecessary burden on those affected
 - Does not restrict competition, unless demonstrated net benefit
- Not unduly prescriptive
 - Performance and outcomes focused
 - General rather than overly specific
- Accessible, transparent and accountable
 - Readily available to the public
 - Easy to understand
 - Fairly and consistently enforced
 - Flexible enough to deal with special circumstance
 - Open to appeal and review
- Integrated and consistent with other laws

- Addresses a problem not addressed by other regulations
- Recognises existing regulations and international obligations
- Communicated effectively
 - Written in ‘plain language’
 - Clear and concise
- Mindful of the compliance burden imposed
 - Proportionate to the problem
 - Set at a level that avoids unnecessary costs
- Enforceable
 - Provides the minimum incentives needed for reasonable compliance
 - Able to be monitored and policed effectively

Good process key to good regulation

In Australia, like in many OECD countries, the nature of regulatory management and reform has changed over the last few decades (OECD 2002). What began as ‘deregulation’ evolved into a focus on regulatory reform – encompassing a mixture of deregulation, re-regulation and initiatives to improve the effectiveness of regulation. In more recent years, there has been growing recognition that government has an ongoing role in ensuring the quality of the regulatory system.

The Australian Prime Minister’s 1997 statement (*More Time for Business*) highlighted the government’s commitment to reforming regulation making.

In order to minimise the burden of regulation on business, the government is firmly committed to reforming regulation making. Improving the regulatory environment starts at the policy development level. (CoA 1997, p. 65)

The Government noted that a cultural change in regulation making was required.

Minimising the regulatory burden on small business requires a change in the regulation making culture. Regulation should not only be effective, but also the most efficient way of achieving the objectives at hand. To foster this cultural change, the Government will introduce reforms to the way regulation is made by requiring a cost-benefit analysis for regulation that is likely to affect business or restrict competition. (CoA 1997, p. 66)

Regulation Impact Statement process

Consequently, among the more important Australian Government initiatives of recent years have been those which require the use of Regulation Impact Statements (RISs) in the development phase of regulation.²

Preparation of a RIS is a critical feature of the regulation making process, primarily because it formalises and provides evidence of the steps that should be taken in policy formulation. It helps ensure that options to address a perceived policy problem are canvassed in a systematic, objective and transparent manner, with options ranked according to their net economic, social and environmental benefits, and from a community wide perspective. The RIS embodies this analytical process (ORR 1998).

The main role of the RIS is to improve government decision-making processes by ensuring that all relevant information is represented to the decision maker. In addition, after the decision has been made, the RIS is tabled in Parliament or may be published elsewhere, providing an open and transparent account of that decision.

In March 1997, the Australian Government made the RIS requirements mandatory for all reviews of existing regulation, proposed new or amended regulation, quasi-regulation and proposed treaties involving regulation, which will directly or indirectly affect business or restrict competition. A limited range of exceptions apply (ORR 1998).

The RIS requirements apply to all Australian Government departments, agencies, statutory authorities and boards that review or make regulations, including agencies or boards with administrative or statutory independence. At the national level and in most States and Territories, there are RIS requirements in place, but their potential has yet to be fully realised.

Seven elements of a RIS

The RIS documents seven key elements essential to good process in regulation-making. A concise account is required of:

1. the problem or circumstances which give rise to the need for policy action;
2. the desired objective(s);

² While the RIS process focuses on the *flow* of regulation, the *stock* has also been reviewed. Under the 1995 inter-governmental agreement on *National Competition Policy*, some 1800 reviews of legislation impacting on competition have been carried out (box 1).

3. the options (regulatory and non-regulatory) for achieving the desired objective(s);
4. an assessment of the costs and benefits of each option – for consumers, business, government and the community;
5. a consultation statement (describing the process and feedback);
6. a recommended option; and
7. a strategy to implement and enforce the preferred option and review its operation.

Role of the ORR

The Office of Regulation Review (ORR), which is part of the Productivity Commission and shares its statutory independence, is the Australian Government's 'watchdog' over the RIS process. The ORR provides advice to approximately 100 regulators. Departments and agencies are required to consult with the ORR early in the policy development process to determine the RIS requirements. The ORR assesses and advises decision makers (such as Cabinet) about the adequacy of the RIS at the decision-making and tabling stages and reports on compliance with the Government's RIS requirements in the annual report *Regulation and its Review*. The ORR provides training on the RIS requirements to around 300 departmental policy officers each year. The ORR oversees the RIS process and does not advocate particular regulatory outcomes.

RIS compliance record

The Australian Government's RIS process has yet to realise its full potential. For example, of the 85 regulatory proposals which required a RIS in 2004-05, the compliance rate at the crucial decision-making stage dropped to 80 per cent, from 92 per cent (114 proposals) in 2003-04 (PC 2005). Also of concern is that compliance has tended to be poorest where it matters most. The ORR ranks RISs according to the impacts of the proposals. It found that that compliance at the decision making stage was only 67 per cent for regulatory proposals with more significant impacts on the community. Unfortunately, this is consistent with the experience in most earlier years.

In many cases, Australian regulators have made no attempt to prepare a RIS. Where a RIS was prepared, common failings (Banks 2003) included:

- poor definition of regulatory problem and objectives;
- inadequate consideration of feasible regulatory and non-regulatory options;
- incomplete cost/benefit assessments; and

- inadequate consultation with relevant stakeholders and the community.

There is also scope for improving the timing of RISs. As noted, they need to be prepared early in the policy development process if they are to assist decision-making. Instead, in some cases they are being treated as an 'add-on', and prepared after policy decisions have already been made. In those circumstances, the RIS can become little more than ex-post rationalisation. Its content may end up being adequate, but it makes little or no useful contribution to policy development.

Concerns remain

Despite the introduction of RISs and other initiatives by Government to improve regulation in the late 1990s, over recent years business groups and others have increasingly aired concerns about the growth of regulation and its effects. For example, the Business Council of Australia (2005) argued that regulation is generating large and unnecessary compliance burdens on business and the community, as well as high administrative costs for government. Many other groups, including representatives of manufacturers, builders, farmers and small business have raised similar concerns and called for further reform.

Several studies have provided crude estimates of either total business compliance costs or total costs of regulation. Lattimore et al. (1998) estimated compliance costs at around \$11 billion in 1994-95. A 2001 OECD study estimated that Australian tax, employment and environmental regulations imposed some \$17 billion in direct compliance costs on small and medium enterprises in 1998. A 2005 study by the Australian Chamber of Commerce and Industry claimed that the total cost of regulation could be as high as \$86 billion, or around 10 per cent of GDP. However, quantifying these costs is not easy and these estimates, particularly those at the higher end, should be treated with caution. Furthermore, many of these costs are a necessary part of a robust and modern regulatory system. Therefore, only some of these costs are likely to be unnecessary.

The costs of regulation to business involve not just extra time, paperwork and capital outlays, but also costs associated with deflecting management from the core activities of the business (Regulation Taskforce 2006). Compliance matters can consume up to 25 per cent of the time of senior management and boards of large companies. The impact is even greater for small businesses, which generally do not have the capacity to deal with, and keep abreast of, the regulatory morass. Regulation can thus stifle innovation and crowd out productive activity in the 'engine room' of Australia's economy. At the same time, it involves substantial government resources and, thus, significant burdens on taxpayers.

Having made important progress in many policy areas, Australia now risks undermining recent gains through burgeoning regulatory imposts on business. Accordingly, it is important to introduce reforms that can provide relief on a sustainable basis.

More needs to be done

In late 2005, the Prime Minister and Treasurer announced the establishment of the Regulation Taskforce to identify actions to address areas of Australian Government regulation that are 'unnecessarily burdensome, complex, redundant, or duplicate regulations in other jurisdictions'. The main focus was not on policy as such, but rather on any undue costs for business in the implementation of policy through regulation.

In its report to Government, entitled *Rethinking Regulation*, the Regulation Taskforce (2006) noted the importance of recognising the forces behind the growth in regulation, if sustainable solutions are to be found. The most fundamental of these is the changing needs and expectations of society itself. Some of this is a natural and desirable consequence of rising affluence and increased scientific knowledge. However, the Taskforce was of the view that a more problematic influence has been the increase in 'risk aversion'.

According to the Regulation Taskforce, any adverse event – especially where it involves loss of life, possessions, amenity or money – is laid at government's door for a 'regulatory fix'. The pressure on government to 'do something' is heightened by intense, if short lived, media attention.

In responding to such pressures, governments themselves are attracted to regulatory solutions to demonstrate their concern and because the costs are typically diffuse and difficult to measure. Moreover, each regulatory solution tends to be devised within individual government agencies (policy 'silos'), with the cumulative impact of regulation across government being poorly understood and rarely taken into account.

The Taskforce considered that a culture to 'regulate first, ask questions later' appears to have developed. Even where regulatory action is clearly justified, options and design principles that could lessen compliance costs or side-effects appear to be given little consideration. Further, agencies responsible for administering and enforcing regulation have tended to adopt strict and often prescriptive or legalistic approaches, to lessen their own risks of exposure to criticism. This, in turn, has contributed in some areas to excessively defensive and costly actions by business to ensure compliance.

The Taskforce identified a forward agenda comprising 100 reforms to existing regulation that would provide relief to business, and proposed that about another 50 areas of regulation be investigated in greater depth. In addition, the Taskforce considered how the processes and institutions responsible for regulation could be improved to avoid the same problems simply re-emerging.

Strengthening the RIS process

On 8 April 2006, the Australian Government provided an interim response to the Taskforce report, with a final response expected in July 2006. In its interim response, the Australian Government endorsed the following **six principles of good regulatory process**.

- Government should not act to address ‘problems’ until a case for action has been clearly established.
 - This should include establishing the nature of the problem and why actions additional to existing measures are needed, recognising that not all ‘problems’ will justify (additional) government action.
- A range of feasible policy options – including self-regulatory and co-regulatory approaches – need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework.
- Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.
- Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements.
- Mechanisms are needed to ensure that regulation remains relevant and effective over time.
- There needs to be effective consultation with regulated parties at all stages of the regulatory cycle.

The Australian Government’s endorsed the Taskforce recommendation that **rigorous cost-benefit analysis** be employed in regulation-making, with such analysis used to compare different options and to incorporate **risk analysis**. Departments and agencies responsible for making regulations should build a capacity to undertake cost-benefit analysis (including risk assessment). The Government also agreed to explicitly broaden the Office of Regulation Review’s training/advisory role to include providing technical assistance on cost-benefit analysis.

The Government agreed to mandate the use of the *Business Cost Calculator* for all regulatory proposals that potentially involve material compliance burdens (box 2).

Box 2 Business Cost Calculator

This interactive costing tool helps measure the compliance costs of regulation and, thus, the impact of regulation on business (both large and small).

The tool enables the user to systematically cost the various activities or tasks a business is required to undertake to comply with a particular regulation or policy option. Categories of cost include 'notification', 'education', 'permission', 'purchase cost', 'record-keeping', 'enforcement', 'publication and documentation', 'procedural' and 'other'.

The costing tool provides a standardised and streamlined process for a key input to policy development and complements existing regulatory process, such as the Regulation Impact Statement.

The availability of an easy-to-use method for costing regulation should encourage policy-makers to assess the compliance burden of both proposed and existing regulations. In so doing, it should also lead to more effective consultation with business to generate the data the tool depends on.

The *Calculator* is available at www.industry.gov.au/businesscostcalculator.

Source: Regulation Taskforce (2006).

On **consultation**, the Government has accepted the recommendation that there should be a whole-of-government policy on consultation requirements, setting out best practice principles that need to be followed by all agencies when developing regulation. The policy should be applied rigorously to all major initiatives, and cover all aspects of developing regulation, from the policy proposals/'ideas' stage through to post-implementation reviews. Where consultation requirements are not followed, reasons should be given.

The Government has also agreed to strengthen **operational aspects** of the RIS process. Grounds for a RIS to be deemed 'inadequate' have been tightened. Apart from the use of cost-benefit analysis, risk analysis and quantifying compliance costs already mentioned, the RIS should also document:

- relevant existing regulations at all levels of government (Commonwealth, state/territory and local) and explain why they do not suffice; and,
- directly relevant international standards and, where a proposed regulation differs from them, to identify the implications and fully justify this variation.

The Australian Government also agreed to institute arrangements to ensure that, unless there are exceptional circumstances, a regulatory proposal with material business impacts cannot proceed to Cabinet or other decision maker unless it has complied with the Government's RIS requirements.

The Government is yet to respond to about half the recommendations made in the report, including that the *Legislative Instruments Act 2003* be amended to include requirements for good regulatory process and that ministerial responsibility for overseeing the government's regulatory processes and reform program should be elevated to Cabinet level.

Conclusion

Australia has undergone a remarkable period of microeconomic reform over the past two decades which has involved losses for some, but yielded substantial net gains to the wider community. And more reform will be needed if Australia is to continue to meet the economic and social challenges ahead, particularly with an ageing population.

Improving regulation can help meet the future challenges. While bad regulation can be reformed, the task can be daunting. Once regulations are in place, expectations and interests settle around them. Change can be disruptive and it can be strongly resisted by interested parties – including regulators themselves.

It is clearly preferable to avoid introducing in the first place the kind of regulation that will subsequently need to be reformed (as opposed to other modifications that may need to meet changing circumstance). A common refrain from business groups is that 'prevention is better than the cure'. This highlights the critical importance of having policy development systems in place that can yield the right kind of regulatory solutions to perceived economic, social and environmental problems.

Recently, the Australian Government has reaffirmed its commitment to improving the business environment by strengthening its requirements for good regulatory process. The initiatives are aimed at embedding the RIS process into the policy development process for all proposed regulations that are likely to affect business by employing rigorous cost-benefit analysis and, where appropriate, incorporating risk analysis, quantifying compliance costs and strengthening consultation requirements. These initiatives may be of interest to Korea.

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