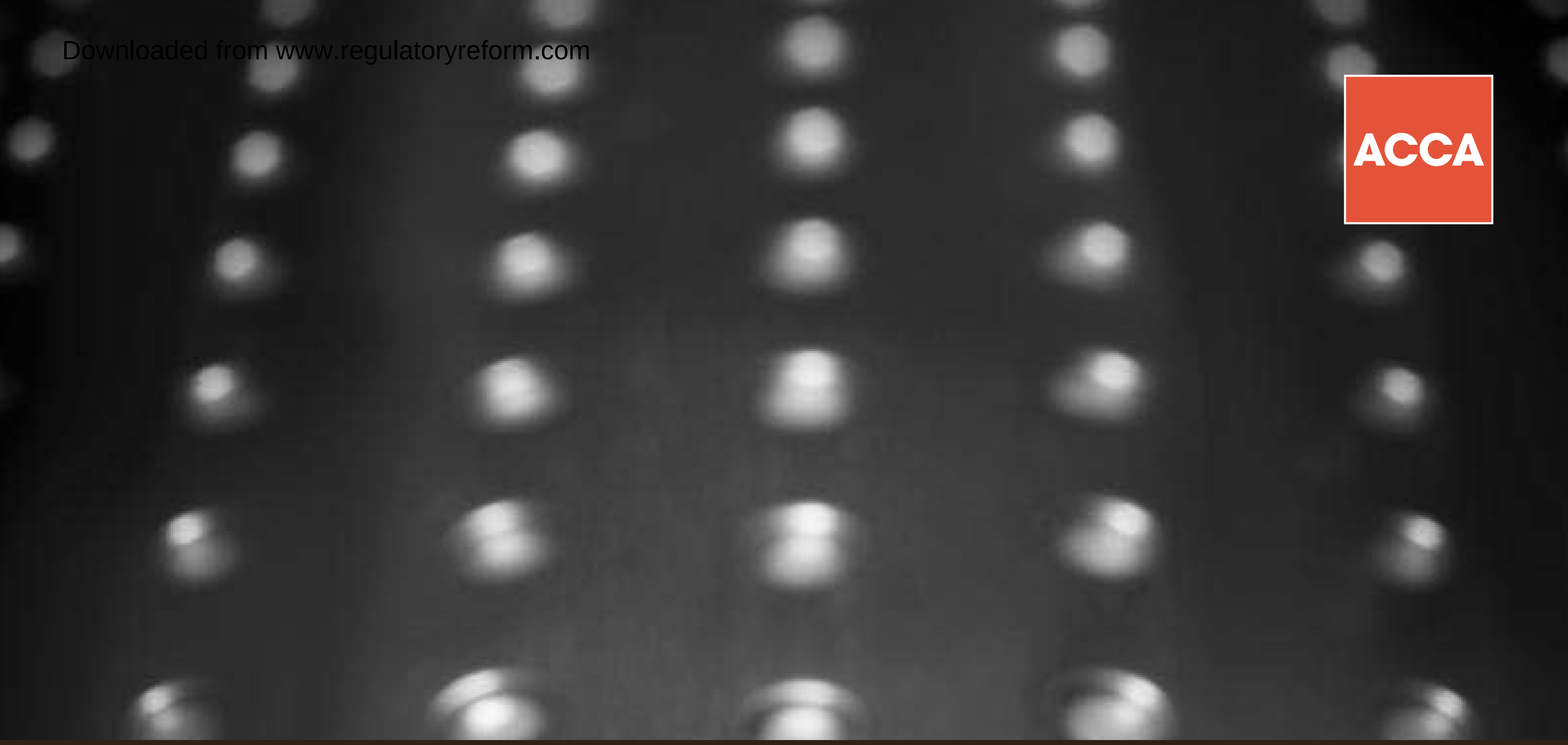
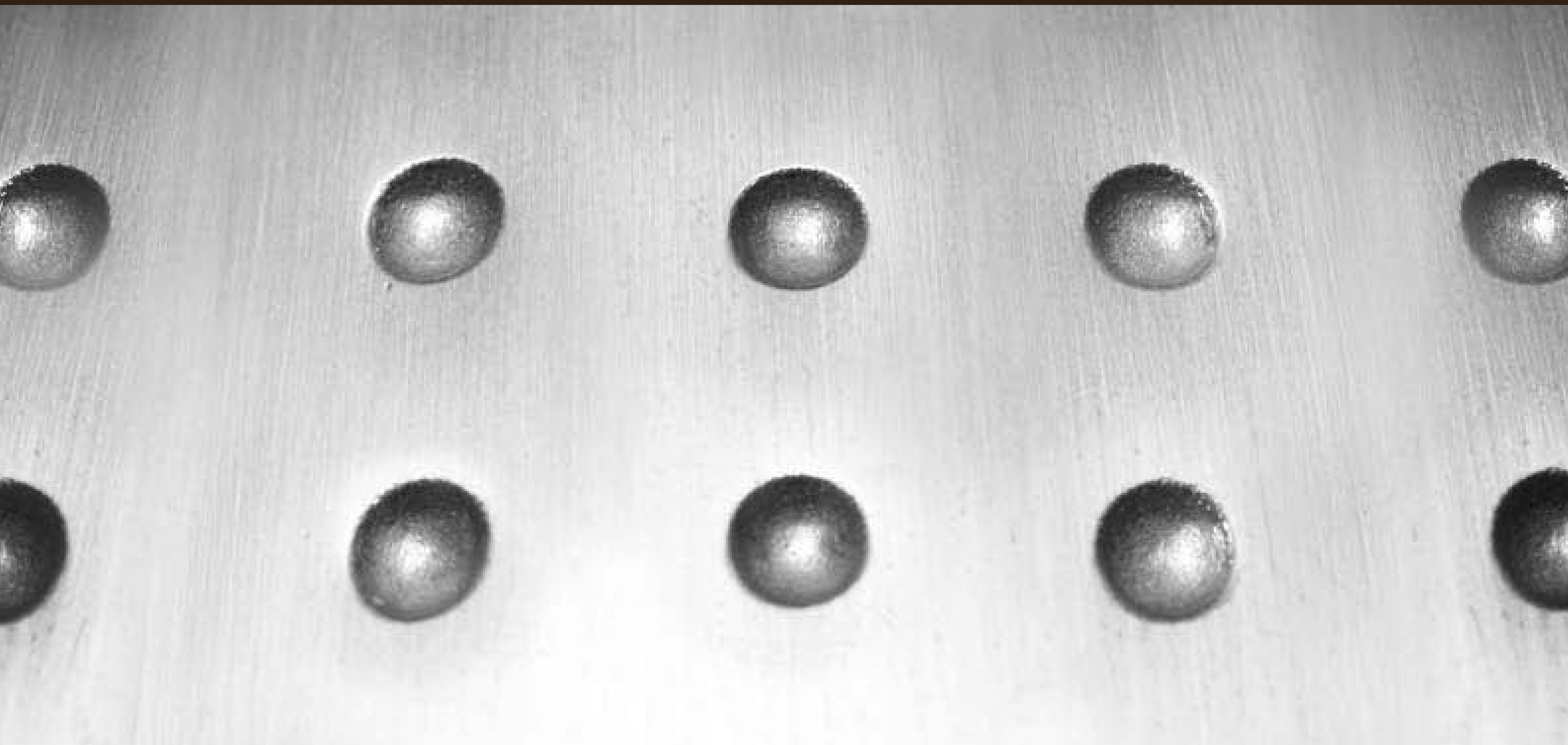


ACCA

ACCOUNTANTS FOR BUSINESS

Coming of age: what next for the UK regulatory reform agenda?



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ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies at all stages of their development. We seek to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 140,000 members and 404,000 students in 170 countries, helping them to develop successful careers in accounting and business, based on the skills required by employers. We work through a network of 83 offices and centres and more than 8,000 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

ABOUT ACCOUNTANTS FOR BUSINESS

ACCA's global programme, Accountants for Business, champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

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Few dispute the need for regulations or doubt their importance to the functioning of healthy and efficient markets. Yet year after year, accountants in industry and practice must deal with a relentless flow of new rules. As the small business sector's most trusted advisers, they witness first-hand the effects of ill-conceived regulation on enterprise, employment, investment and innovation.

This report considers how this can still be the case in a country such as the UK, whose regulatory reform programme is considered to be world-class. Based on a template of regulation-as-taxation, it builds on first principles to discuss the fundamental shortcomings of the UK's Better Regulation programme and how it can be reformed in order to deliver better outcomes for small and medium-sized enterprises.

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Foreword

The party conference season in 2009 was a decisive time for the UK's world-leading Better Regulation agenda. During the last quarter of 2009, the Government and Opposition (as they were) published more than 10 substantial papers between them on regulatory reform, promising an end to the 'nanny state', a bonfire of the quangos, a new era of trusting citizens, protecting the public and helping small businesses.

What was much more important than the conference rhetoric, however, was the manner in which lines were drawn: one side called for a dramatic shift away from regulation and towards its various alternatives, citing the cost to struggling businesses and the damage done to Britain's competitiveness and entrepreneurial spirit. The other side pointed out that regulation was a public good; it may be delivered inefficiently at times but its value should not be dismissed lightly. It even signalled that some areas of regulation, such as employment law, were so important they should be safe from cuts.

If all this sounds familiar, it is because exactly the same arguments have been employed in the much more public and bitterly fought debate over fiscal policy that has raged since the UK went into recession in 2008. The same dilemmas have also accompanied the burgeoning regulatory reform agenda from Brussels to Bhutan and from the White House to Whitehall. The analogy between regulation and tax transcends national and ideological boundaries because all democratic governments have a mandate to regulate, to tax and to spend, and all are limited in these respects by what their national economies can afford. The trick is to deliver the benefits of regulation in a manner that is efficient, sustainable and effective.

This report aims to recapture the momentum of late 2009 in the UK and approach these challenges from first principles, at a time when the regulatory reform agenda in Britain and abroad is facing increasing scepticism from both its supporters and its detractors. Written with the needs of small and medium-sized enterprises (SMEs) in mind, *Coming of Age: What Next for the UK Regulatory Reform Agenda?* draws on the experience of ACCA's members, on the views of our respected and influential SME Committee, on ACCA's own experience as a (self-)regulator and on an extensive review of the literature on regulatory reform in Europe and beyond.

Executive summary

BACKGROUND

Although the UK is widely acknowledged as a global leader in regulatory reform, its Better Regulation agenda has reached a plateau. Since 2005, it has made a great deal of progress in terms of methodology and political learning, and has delivered against most of its explicit objectives. However, the Government's approach to the programme is still far from joined up and has achieved little in terms of improving businesses' perceptions of regulation. Worse, the financial crisis of 2008–9 and its legacy of fiscal contraction have called the entire project into question and made regulation much more attractive.

FINDINGS

Champions of the Better Regulation agenda are increasingly frustrated because 'bad regulation' is an intractable, 'wicked' problem. Caught between the contradictory narratives of different stakeholders, government policy in this area struggles for focus, consistency and relevance. Regulatory management will never become a 'tame' problem, but an approach that borrows from the rules of taxation and public spending can provide a more workable narrative. Tax-inspired principles of regulation are compatible with today's Better Regulation programme.

Improving the efficiency of regulation could produce substantial savings, but this requires an appreciation of the flow and cumulative effects of regulation, which in turn relies on Impact Assessments (IAs). Although the quality of IA reports is improving and their use in Parliament is on the rise, these are still largely seen as perfunctory or as a standardised means of justifying decisions. One crucial but often ignored shortcoming is the poor distinction between regulatory costs and regulatory burdens, which can lead to the identification of false burdens and savings and test the credibility of regulatory reform.

Managing regulatory cross-subsidies is, to date, the least understood aspect of regulatory reform, and there are no performance measures in place to ensure appropriate scrutiny. Recent work on understanding and managing public risk has given policy-makers some valuable tools which will now need to be embedded into the machinery of government. Even so, a crucial limitation exists in that managing cross-subsidies is a political act beyond the remit of civil servants and independent bodies.

So far, learning and innovation in the regulatory apparatus has been focused on the tools and methods associated with the Better Regulation agenda. However, more substantial improvements still elude the UK regulatory system. One implication of this, as well as of the importance of regulatory churn to perceptions of the business environment, is that intuitive, simple solutions such as the 'one-in, one-out' rule are unlikely to produce the results expected of them.

One very useful concept recently introduced into the Better Regulation agenda is that of the regulatory services industry; indeed, the function of intermediaries can influence regulatory outcomes more than the design of regulations themselves. In its brief lifetime, the Local Better Regulation Office (LBRO) has come to own the regulatory services agenda to a large extent and has produced an impressive amount of research. However, it has focused mostly on the public sector – which is only a small, and hardly the most effective, part of the regulatory services industry.

Finally, managing the Better Regulation programme as whole relies on seriously flawed measures of regulatory quality and progress. The Government's preferred measures, such as administrative savings, are of course useful as internal management and reporting tools. They are not, however, meaningful, reliable or final numbers in any sense. All this is deeply harmful to the credibility of the regulatory reform agenda. There are, however, fairly cheap and robust survey-based alternatives that deserve further exploration.

RECOMMENDATIONS

The regulatory reform agenda is not going through a mid-life crisis, as some have suggested, but is only just coming of age. Government should prepare for the very likely possibility that it will never be able to transform Better Regulation into a 'tame' problem by design (or, worse, by definition). If it is to remain relevant, the UK's regulatory reform programme will need a substantial change of narrative, as well as new tools.

Governments have acknowledged for some time that regulatory activity should be undertaken only in the pursuit of explicit and clearly defined benefits that have been shown to outweigh its costs. But a mature regulatory reform system should also have three additional overarching objectives: value for money; fair and sustainable cross-subsidies and risk sharing; and a value adding regulatory services industry. All of this will rely on regulators thinking small first, developing rules in a 'bottom-up' fashion for the vast majority of businesses that are very small.

The theme of value for money in regulatory reform, naturally the domain of civil servants, is the best developed, but its governance is as yet incomplete. It should ideally be led by an independent body reporting to Parliament, mirroring the role and resources of the National Audit Office (NAO). In future, the Better Regulation Executive (BRE) needs to formally assume leadership of the value for money agenda, becoming appropriately resourced and fully independent. One of the BRE's primary tasks in this capacity could be to seriously consider Government's approach to developing better regulators. A thorough assessment of skills needs in regulatory reform could kick-start badly needed changes in this respect.

The value for money agenda now needs to move away from administrative burdens reduction and prioritise the flow and policy costs of regulation. This will require the establishment of a medium-term planning and review cycle, building on the Forward Regulatory Programme format, and a programme of thematic reviews of regulation focused on regulatory 'bottlenecks'. Crucially, the measurement and communication of regulatory benefits needs to be improved if the legitimacy of the regulatory reform programme is to be maintained. That said, recent successes with IAs should be celebrated and learnt from in a drive to improve other instruments, especially post-implementation reviews.

Value for money is only part of the story; cross-subsidies are inevitable in regulation and need to be managed. Although independent bodies and external experts might help to provide clarity in the more complex cases, this agenda should be permanently owned at Cabinet level and subject to the highest possible levels of public scrutiny.

The rise of the regulatory services theme within the regulatory reform agenda is excellent news, and this theme should be extended to encompass the full range of private and public sector intermediaries. Its aim should be to remove the organisational, cultural and resource barriers to integrated delivery of regulatory agencies by building professionalism and advisory capacity in the public sector. On the other hand, Government also needs to acknowledge its limitations in the provision of regulatory advice, and further engage the private sector – especially accountants, who are the most popular advisers of small and medium-sized enterprises (SMEs). Additionally, it needs to obtain a much better understanding of compliance behaviour among small businesses, based on grass-roots information.

Finally, the Government needs to underpin this three-fold agenda for Better Regulation with better measurement. This agenda has been guided for years by the tenet that what gets measured gets done; however, developing the right measures of success is paramount. Government needs to rely more on independent evidence of real-world outcomes – real influence on the behaviour of businesses and individuals that will appeal to a wider range of stakeholders, and integrate better into the policy-making process.

1. Better regulation: the state of play

THE STORY SO FAR

By any standards, the UK's regulatory framework is one of the country's greatest economic advantages (Schwab 2009). According to the World Bank, the UK is the fifth best place in the world and the best place in Europe in which to do business (World Bank 2009). It probably ranks even higher in its efforts to improve the quality of its regulatory system; the OECD recently concluded that 'the vigour and breadth of the United Kingdom's Better Regulation policies are impressive, which makes it well placed to address complex regulatory challenges' (OECD 2009a).' Indeed, many other countries look to Britain for leadership in the regulatory reform agenda (HoC Regulatory Reform Committee 2008a), and there is evidence that the UK's initiative has been crucial to the diffusion of good practice in Europe (Wegrich 2009).

The OECD traces the origins of the UK's regulatory reform agenda back to 1985, to the White Paper, *Lifting the Burden*. This was an early attempt to assess the economic impact of regulation and recommended, among other things, an early standard of impact assessments. It was not until 1997 that regulatory reform was explicitly linked to the small business agenda, a move which coincided with the earliest instance of a shift in emphasis towards 'better', rather than less, regulation (OECD 2009a). The earliest formal Impact Assessments date back to 1998 (BCC 2010), and standards of consultation were first introduced in 2000 (HM Government 2008a).

To this day, 2005 has been arguably the most important year for the regulatory reform agenda, with the combined publication of the Hampton Report (Hampton 2005), setting out principles of good regulation that are still in place today (see Box 1), the commissioning of the Davidson Report and its guidelines on transposition of EU directives (Davidson 2006), as well as the Better Regulation Task Force report, Less is More, which kick-started the UK's efforts to reduce the administrative burdens of regulation by a net 25% (Better Regulation Taskforce 2005). The same year saw the establishment of the Better Regulation Executive (BRE), with a mandate to oversee the UK's regulatory reform programme. The establishment of Common Commencement dates for new regulations followed in 2006.

BOX 1: THE HAMPTON PRINCIPLES

- Regulators, and the regulatory system as a whole, should use comprehensive risk assessment to concentrate resources on the areas that need them most.
- Regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take.
- No inspection should take place without a reason.
- Businesses should not have to give unnecessary information, nor give the same piece of information twice.
- The few businesses that persistently break regulations should be identified quickly and face proportionate and meaningful sanctions.
- Regulators should provide authoritative, accessible advice easily and cheaply.
- Regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work.
- Regulators should recognise that a key element of their activity will be to allow, or even encourage, economic progress and only to intervene when there is a clear case for protection.

In mid-2007, part of the former Department for Trade and Industry (DTI) became the Department for Business, Enterprise and Regulatory Reform (BERR), acknowledging regulatory reform as a priority at the highest level. Controversially, the new department incorporated the BRE, once part of the Cabinet Office. BERR restructured again as the Department for Business, Innovation and Skills (BIS) in early 2008, ahead of the 2008–9 financial crisis.

Since then, the UK's regulatory reform framework has been strengthened further with the publication of the first Code of Practice on regulatory guidance (BIS 2009b), the launch of the Anderson Review of regulatory guidance (BIS 2009c), and the establishment of the Local Better Regulation Office (LBRO). In 2008, the Government took a bold step in consulting on a world-first system of Regulatory Budgets (HM Government 2008b), which was then quietly abandoned in April 2009 (McFadden 2009). Instead, the UK's first Forward regulatory Programme (an alternative to the Regulatory Budgets considered in consultation) was published in March 2010 (HM Government 2010).

By the end of 2009, the UK's administrative burdens reduction was on track to deliver its 25% net reduction target decided in 2005. A net reduction of administrative burdens by £2.9bn per annum had already been achieved against the 2005 baseline, along with a reduction of the policy costs of regulation by £1.2bn per annum (HM Government 2009b). These savings compare very favourably with the £15.5m per annum that the Government was spending on the Better Regulation programme at the latest estimate (HMT 2010a).[1]

1. All costs are under the Programme Object code 'P25 S130331 Better Regulation' and include Programme Object Groups 'P25 Better Regulation Admin', 'P25 Better Regulation Programme', 'P25Local Better Regulation Office' and 'Local Better Regulation Office Grant in Aid'.

RUNNING OUT OF STEAM?

Despite all these changes, the billions of savings achieved, and the UK's tradition of best practice in regulatory reform, satisfaction with the regulatory state among small businesses has remained consistently low. The National Audit Office's (NAO) surveys of business perceptions suggest that even as the UK gathers accolades for reducing burdens on business, little of this work is making an impact on the ground – or if it is, this is cancelled out by the regulatory impetus of politicians (FDS International 2010).

Other critics suggest that in the absence of a joined-up approach to regulatory reform, the progress made by individual government departments has often been undermined by the high-profile regulatory projects of others. Costly or ill-timed regulations can be introduced despite assurances to the contrary,[2] common commencement dates can be ignored (ACCA SME Committee 2009a), and political rhetoric can disguise the benefits of regulatory simplification (ACCA 2010a).[3]

Survey evidence covering the period before the NAO assessments began suggests that regulation only became relatively less of a problem for small businesses in the very early days of regulatory reform, from 1988 to 1991 (See Figure 1). Even this trend probably had little to do with Government policy, as it coincided with the dramatic rise of access to finance and flagging demand as business concerns ( ).[4]

2. A case in point is the extension of the right to request flexible working which came into effect in April 2009, despite assurances to the contrary by the Business Secretary.

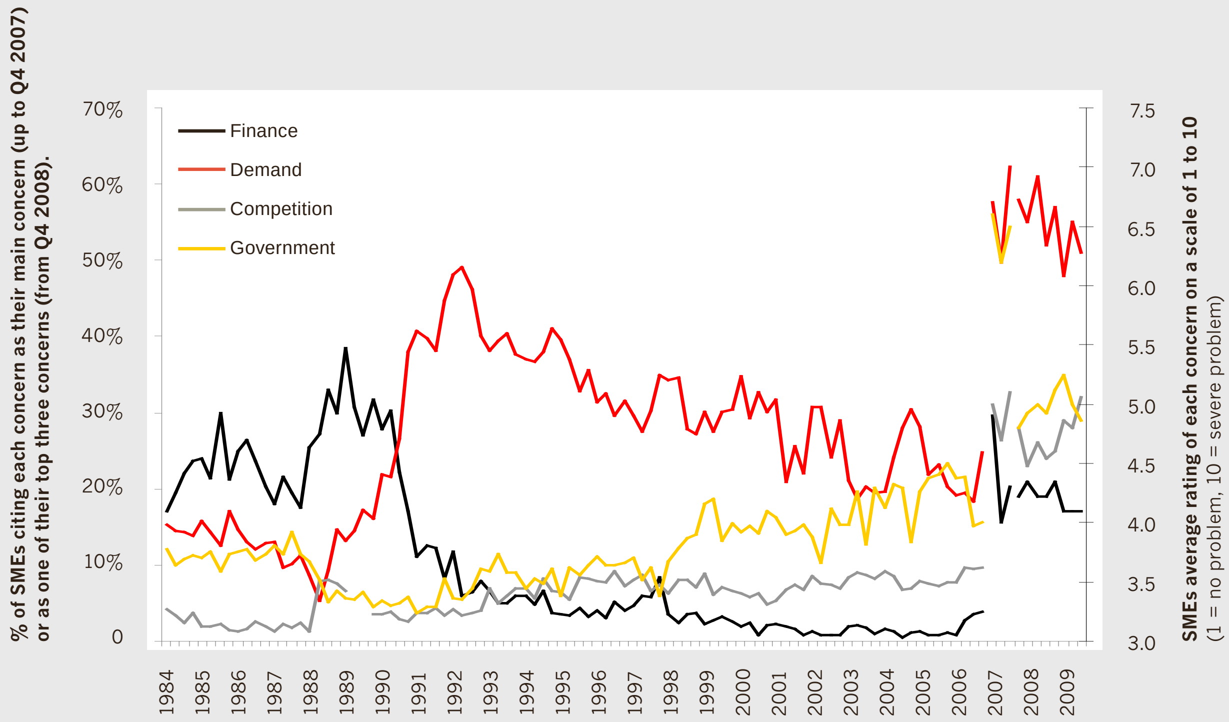
3. This has been the case throughout consultation on the Equality Bill, which was held up as an example of poor communication in the regulatory reform agenda in ACCA (2010a).

4. Greene (2009) reviews the first 25 years of data on small business performance sourced through the Open University Business School's Quarterly Survey of Small Business in Britain which is sponsored by ACCA and Barclays Bank. Due to the relative ranking of different business challenges employed in these questions, it is possible for regulation to appear to be falling in significance as a barrier to business if regulation is gaining significance more slowly than other challenges.

Meanwhile, other stakeholders are also disappointed by trends in regulatory reform – from unions and consumer representatives alarmed by what they see as an undue prioritisation of the demands of business and disregard for the benefits of regulation (BIS 2009e); or from those in local government and enforcement agencies juggling contradictory demands from central government under ever-tighter financial constraints (Tiessen et al. 2009).

The UK's status as a leader in regulatory reform further complicates the choices of policy-makers. New methodologies must be implemented with little relevant[5] outside experience to draw on – presenting a choice between wasteful trial and error or becoming a regulatory reform laggard. This dilemma has never been more obvious than in the most ambitious reform initiative to date, the Government's consultation on a system of Regulatory Budgets in 2008 (BIS 2008b; 2009e).

Figure 1: Problems identified as priorities by small businesses, 1984 to 2010



Source: Greene (2009).

5. The Better Regulation Executive has note, and we must also concede, that some of the jurisdictions outperforming the UK in terms of the effects of regulation on business are so different in terms of their political and economic structures that replicating their success may be impossible, or indeed, undesirable.

These problems are not unique to the UK but echo the experience of all countries that aspire to be Better Regulation leaders. They are symptomatic of what Wegrich calls the 'middle age' of Better Regulation (Wegrich 2010).

We believe that, far from going through a mid-life crisis, regulatory reform in the UK is only just coming of age and is in need of a new narrative, new tools and new governance arrangements. Most importantly, it will need to align itself ever more closely to other, more widely accepted policy goals – from government efficiency and transparency, to the promotion of enterprise and economic growth, to consumer protection and social justice.

One particularly troublesome possibility is that champions of Better Regulation may be taking on a 'wicked' rather than a 'tame' problem (Rittel and Webber 1973). The recent Hartwell Paper on climate change policy offers an interesting description of such problems, one which Better Regulation stakeholders will find eerily familiar:

> *What makes a problem 'wicked' is the impossibility of giving it a definitive formulation: the information needed to understand the problem is dependent upon one's idea for solving it. Furthermore, wicked problems lack a stopping rule: we cannot know whether we have a sufficient understanding to stop searching for more understanding.*
>
> *That is frustrating for politicians. So policy makers frequently respond to wicked problems by declaring 'war' on them, to beat them into submission and then move on. Indeed, almost any 'declaration of war' that is metaphorical rather than literal is a reliable sign that the subject in question is 'wicked'…. The public is often initially stirred by such declarations of war; but, as wicked problems demonstrate their intractability,* [it] *soon grows weary of them.* (Prins et al. 2010)

Successive UK governments have declared war on red tape, announced 'bonfires of the quangos' and pledged to roll back the 'nanny' state. At the time of writing (2010), the UK Government has just launched a second website inviting citizens and entrepreneurs to nominate regulations they would like to see repealed – this is in addition to the one maintained by the European Commission. Some UK stakeholders have responded with equal kitchen-sinking abandon, most notably the Institute of Directors (IoD) with their 269 regulatory suggestions in 2009 (HM Government 2009a).

The present paper strongly endorses such efforts. As we will argue, however (see Section 2), the Better Regulation agenda is up against a 'wicked' problem and stakeholders may never have the appropriate narrative, tools and vocabulary to address this.

REGULATION AND REFORM IN THE POST-CRISIS ERA

The financial crisis of 2008–9 called most of the rhetoric on regulatory reform into question in the most dramatic way possible. In the midst of a profound economic downturn, brought about to some extent by a failure of governance, market discipline, regulation and supervision (ACCA 2008), the argument that regulation was somehow too intrusive, or poor value for money, seemed to ring hollow.

A recession or weak recovery challenges other key premises of the current regulatory reform agenda, particularly administrative burdens reduction. Insofar as there is a link[6] between the cost of regulation and productivity, it must become weaker under such conditions. With businesses operating well below capacity (OBR 2010), regulatory 'savings' are less likely to translate to increased output or profit. Crucially, time saved by entrepreneurs, a key component of these savings, is now less likely to be reinvested in the business (Thurik 2009).

ACCA acknowledged all this in our submission to the House of Commons Regulatory Reform Committee's inquiry into themes and trends in regulatory reform (ACCA 2009c). We also noted that, as the government's fiscal options became constrained by the deteriorating state of the public finances, regulation would increasingly become a more attractive option for policy-makers (Wegrich 2010). This trend could be further reinforced by rising risk aversion and trust in government among the public.

Yet the case for regulation outside financial services has not changed. Trust in the wider UK business community, which was never truly compromised, is once again on the rise; trust in government has retreated from its 2009 highs (Edelman 2010); and citizens around the world trust smaller businesses more than governments, multinationals or any other stakeholder to act according to universal values (Schwab et al. 2010).

More importantly, the financial crisis did not expose a world where workplace injuries, employer misconduct or lapses in food standards were more frequent or damaging than previously thought. The underlying risks are unchanged, and our understanding thereof has not materially improved. Importantly, non-compliance with key regulation did not rise during the worst of the recession (Health and Safety Executive 2010).

On the other hand, the case for regulatory reform in the wider sense is stronger than ever, and a 'deregulatory stimulus' can help compensate for the Government's reduced fiscal discretion. Perceptions of regulation influence business start-up rates and employment decisions, and are therefore central to accelerating recovery and halting the rise in unemployment (BIS 2008).[7] Additionally, regulatory reform could contribute to business survival by reducing distraction among owner-managers (Decker et al. 2008). Finally, in the current adverse credit environment (ACCA 2010b), regulations requiring high levels of investment are more likely to raise irreversible barriers to entry (BIS 2008a).

6. This has been questioned in the case of administrative burdens reduction, in NAO 2008.

7. For the effect of perceived administrative burdens on action taken to start a new business, see Grilo and Thurik (2008).

2. Understanding regulatory reform

FIRST PRINCIPLES: LESSONS FROM TAXATION

Regulation and fiscal policy are two sides of the same coin – both allow the state to use private sector resources in order to deliver public benefits (Posner 1971). Like taxes, regulations are never very popular among those subject to them, although both typically elicit compliance. This is not only due to enforcement, but also because the social benefits of public spending and regulation are widely acknowledged, including by businesses large and small (Freshminds 2009). Between them, regulation and tax-fuelled public spending have built much of the infrastructure on which markets and individual businesses depend.

Those who would wield either instrument of policy face similar challenges. In principle, both fiscal policy and regulation must be justified by market failure. In practice, both inevitably create politically sensitive cross-subsidies. While in fiscal matters the better-off subsidise the worse-off through the re-allocation of income, in the regulatory arena those with access to information, bargaining power and a high tolerance for risk subsidise the less-informed, the powerless or the risk-averse through the re-allocation of risks. In both cases businesses seek to minimise costs; usually legally (by planning and managing their liabilities), but also illegally (through non-compliance or tax evasion).

Finally, both instruments are prone to complexity, because they need to address diverse populations, carefully calibrate tradeoffs, and influence the complex behaviour of regulated parties. Even well-designed systems of regulation and tax can be hard to navigate and open to abuse. This creates demand for advice, guidance and enforcement and gives rise to an industry, part public and part private, to deliver these (BRE 2007). The interaction between regulation, business and the regulatory services industry determines the cost and effectiveness of regulation.

The analogy between regulation and fiscal policy is important because it offers tried and tested ways of thinking about regulation. Regulation is a more complex instrument than tax – and yet its governance is still primitive by comparison. The regulatory reform agenda as it is understood today is barely a quarter of a century old (Wegrich 2010). The rules of fiscal conduct, on the other hand, have evolved over centuries of trial and error. Many of the reporting, auditing and governance tools that are often taken for granted in public spending could be applied to regulation.

It is possible to test this approach. In 2009, ACCA published 12 tenets of taxation (ACCA 2009e) – and a quick examination reveals that they can be applied to regulation with only minimal adjustment, as demonstrated in Table 2.

Governments have acknowledged for some time that regulation of any business activity should be undertaken only in the pursuit of explicit and clearly defined benefits that have been shown to outweigh its costs. But the above analysis of tax and regulation additionally implies three simple operational objectives for regulatory reform.

- Maximise the public benefit gained for each unit of cost imposed on regulated parties.
- Ensure that regulatory cross-subsidies and risk-sharing are fair and sustainable.
- Ensure that the regulatory services industry adds genuine value to both regulated parties and the wider public.

All principles of Better Regulation currently in place in the UK can be reconciled with these objectives. However, the latter have a valuable added advantage, in that they do not rely on a working definition of 'bad' regulation.

Table 2: Extrapolating regulatory principles from taxation

General principles	Tax	Regulation
Liability management vs non-compliance	Acceptance of legal tax planning/ rejection of illegal tax evasion	Accepting legal management of regulatory costs/ rejecting non-compliance
Sustainability	Tax as a sustainable percentage of GDP	Compliance costs as a sustainable percentage of GDP
Simplification and stability	Minimal, predictable changes to tax system	Minimal, predictable changes to regulatory frameworks
Openness, transparency and accountability	Non-discrimination, no hidden subsidies, meaningful consultation	Non-discrimination, no hidden regulatory subsidies, meaningful consultation
Certainty in outcomes and operations	Clarity regarding the boundaries of avoidance and evasion; differential treatment of the two	Clarity regarding the boundaries of regulatory cost management and non-compliance; differential treatment of the two
Competitiveness	Tax levels that maximise welfare in a global, competitive context; calculated to avoid retaliatory measures	Levels of protection that maximise welfare in a global, competitive context; calculated to avoid retaliatory measures
Efficiency	Efficiency of administration for taxpayers and of tax collection for government	Efficiency of compliance for regulated parties and of enforcement/implementation for government.
Sunset clauses	Periodical reviews of the tax system and sun-setting of individual taxes	Periodical reviews of the stock of regulation and sun-setting of regulations and regulators
Clear link from compliance to planned outcomes	Clear link between tax and spending, no unfunded expenditure projections	Clear link between compliance with and outcomes of regulation, no regulatory proposals without appropriate impact assessment
Avoidance of multiple obligations	Avoidance of double taxation	Avoidance of multiple information requests and multiple standards of compliance
Human rights	Respect for the rights to privacy and property	Respect for the rights to privacy and property
Green and other social incentives	Admissibility of tax shifting and tax-funded subsidies that maximise long-term welfare	Admissibility of social as well as economic regulatory outcomes, as well as regulatory subsidies that maximise long-term welfare

THE TROUBLE WITH 'BAD REGULATION'

No government will readily admit that its approach to regulation contravenes any of the principles outlined above. But the terminology of Better (or latterly, Smart) Regulation persists because stakeholders and policy-makers believe that the system currently in place is biased in favour of poor or insufficiently 'smart' regulation. They typically highlight the following four kinds of 'bad regulation', each with its own set of implications.[8]

Bureaucracy

Poor regulation results from the influence of bureaucrats and bureaucratic process over regulation, which leads rules to become detached from the needs of the public and the concerns of regulated parties. The result is a bias towards ad hoc rules and guidance, as well as a swollen and possibly rent-seeking regulatory services industry. This narrative is most often adopted by business associations, but has also been adopted to some extent by the Government and by the House of Commons Regulatory Reform Committee (HoC Regulatory Reform Committee 2008a).

Knee-jerk reactions

Poor regulation results from over-reactions to public risk which has been poorly understood, overly politicised, or exploited by self-interested 'risk entrepreneurs'. The result is a bias in favour of simplistic, intrusive responses aimed at eliminating rather than managing risk. This is the narrative adopted by the Better Regulation Commission (BRC) and most recently by the Risk and Regulation Advisory Council (RRAC) (BRC 2008; RRAC 2009a). It is also popular among representatives of industries exposed to low-probability, high-impact risks – such as financial services or the extractive industries.

Regulatory capture

Poor regulation results from the interference of regulated parties, which manage through their superior insights, resources and political connections to hijack the law-making process. The result is a bias in favour of non-intrusive responses, self or co-regulation and industry concentration. This is the narrative most often adopted by consumer groups, public health stakeholders, unions and sustainability/CSR campaigners (Smokefree Partnership 2010; Vogel 2009).

In addition to the above, theorists of regulation suggest that poor regulation can be the result of poor governance. Fiscal policy and regulation are substitutes, but whereas fiscal policy is constrained by budgets, public scrutiny and value-for-money assessments, regulation is not. The result is a bias in favour of regulatory, rather than fiscal, responses to policy challenges, and for regulations relying more heavily on cross-subsidies (BIS 2008a). Accordingly, the business costs of new regulation have risen by about 11% per annum between 2002 and 2009, more than twice as fast as public expenditures (BCC 2010; HMT 2010b).

In theory, all these perspectives are valid to some extent, and examples of the associated failures can often coincide. An individual business or industry can be at once over-regulated and under-regulated; over-inspected and under-inspected; over-compliant and non-compliant. Its regulators can be at once over-zealous and complacent; its inspectors both intrusive and toothless; its stakeholders both over-protected and under-protected.

Stakeholders, however, tend to each develop a narrative of bad regulation which favours some of these perspectives at the expense of others. Worse, the influence of different stakeholders over government can shift over time, leading to inconsistent policy. As with any 'wicked' problem, the information needed to understand the problem of bad regulation is dependent upon one's idea for solving it.

8. The first three elements of this typology are derived from Wegrich (2010).

THINKING SMALL FIRST

As mentioned above, regulations typically apply to a diverse population of businesses which differ in the impact of their operations and the resources they can devote to compliance. Unsurprisingly, the evidence suggests that the outcomes of regulation can often depend more on the knowledge and compliance resources of individual businesses than on the content of the regulations themselves, and are generally more detrimental (or less beneficial) for those without adequate resources and support (Anyadike-Danes et al. 2009).

The Forum of Private Business has estimated the total in-house costs of compliance for UK SMEs (excluding tax administration) at £7.5bn, and the costs of regulatory advice at £2.6bn. More importantly, its estimates imply that compliance costs for micro enterprises are 10 times as high as a share of turnover and 8 times as high per employee as for a medium-sized business (Forum of Private Business 2009).

Evidence also abounds of other disproportionate effects of regulation on small businesses, which are the norm rather than the exception in the UK economy.[9]

Perceived regulatory burdens can prevent individuals from undertaking early-stage entrepreneurial activity, thus reducing the number of new start-ups (van der Zwan et al. 2010). They can also divert would-be entrepreneurs to the informal economy, to the detriment of all concerned (Ayyagari et al. 2003; Batini et al. 2010). In established small businesses, the costs and restrictions associated with compliance can discourage employment (Fialová and Schneider 2008), investment (Alesina et al. 2005) or innovation (Robson and Kenchatt 2010). Furthermore, because the unit costs of compliance are higher for smaller than for larger businesses, an implicit subsidy arises for big business which can limit competition.

Table 3: Annual costs of complying with regulation among employer SMEs, 2008/9

		As % of turnover	Per employee	Per enterprise
Total internal costs in £million (excluding tax compliance)				
SMEs (1–249)	7,476	0.6%	£816	£6,070
Micro-enterprises (1–9)	5,486	1.3%	£1,684	£5,312
Small (10–49)	1,400	0.3%	£431	£8,137
Medium (50–249)	590	0.1%	£223	£22,089
Costs of external advice (including tax compliance)				
SMEs (1–249)	2,618	0.2%	£286	£2,126
Micro-enterprises (1–9)	1,904	0.5%	£584	£1,844
Small (10–49)	562	0.1%	£173	£3,266
Medium (50–249)	152	0.0%	£57	£5,691

Source: Forum of Private Business, *The Cost Of Compliance on Micro, Small and Medium-sized Business Employers*, July 2009

9. In 2008, the median UK business had no employees. The average business had 4 employees and a turnover of £626,000. The average employer had 15 employees and a turnover of £2.2m (BIS Analytical Unit 2009).

To address these asymmetries, ACCA and other stakeholders often urge policy-makers to 'Think Small First'; a popular and much-abused phrase whose earliest official use can be traced back to the proceedings of the Madrid European Council in 1995 (European Commission 1995). The European Commission made a first attempt to define 'Think Small First' in 2009 (European Commission 2009), and building on this it is possible to identify several complementary aspects of this principle:

The stakeholder approach: Small businesses are the primary customers of government departments and agencies. Government needs to identify and prioritise the sector in consultation, in the development of services and policy in general. BIS, for instance, maintains a Small Firms Consultation Database with guidance on how to engage and prioritise small businesses in consultation and impact assessment (BIS 2009g).

The Impact Assessment or 'SME Testing' approach: When regulations are not specifically designed for SMEs, those costs and benefits of regulation that are unique to the SME sector should be estimated using extrapolations of a standardised model of compliance costs (usually the Standard Cost Model, or SCM). These typically include the use of owner-managers' time in ensuring compliance, familiarisation and information costs, as well as updates of generic compliance systems. BIS issued guidance for a Small Firms Impact Test in 2009, classifying any Impact Assessment that does not include this as 'deficient' (BIS 2009g).

The differential or proportionate regulations approach: Separate regulations or enforcement regimes can be developed for defined groups, proportionate to the resources of regulated entities or to the potential impact of their activities on the public. Typically this will result in a lighter regulatory regime for small businesses, which are exempt from some reporting obligations or subject to simplified requirements.

The zero-subsidy/zero-arbitrage approach: Where the unit costs of compliance for small businesses are greater than those for large businesses, an implicit subsidy can be said to be in place for larger businesses. Regulators should aim to either remove this implicit subsidy or compensate for it, though business support interventions, proportionate rules, or exemptions from compliance obligations.

Conversely, regulators are on the lookout for regulatory arbitrage – the contracting out of activities to small businesses solely in order to reduce compliance costs.[10]

The building block/bottom-up approach: Regulators should begin their work by considering what regulations or enforcement mechanisms would be suitable for the smallest entities, then build on these to develop proportionate regulation for larger entities. This approach leads to different outcomes than the top-down approach, as the structures and risk drivers of a micro enterprise can also be found in the largest of companies – but not vice versa.

Strictly speaking, only the 'building block' or 'bottom-up' approach is a true Think Small First principle. All other approaches would, in theory, allow policy-makers to operate with no regard to the circumstances of small businesses, as long as the appropriate 'SME gatekeepers' are in place to make occasional modifications. In practice, however, all the approaches detailed above are complementary, as they refer to different elements of the policy-making process.

- The stakeholder approach helps to alert policy-makers to developments in the SME sector, optimise their communications and improve their insights.

- The proportionate and zero-subsidy/zero-arbitrage approaches are both helpful in identifying regulations and policies in need of review, with a proportional approach performing best when the impact of policies on SMEs is hard to measure or highly complex.

- The building-block approach provides a good model for the design of new regulations as well as for the wholesale review of existing ones.

- The impact-assessment approach provides a framework for validating the SME-friendliness of regulations developed through the above process and particularly the 'building block' or assumptions employed in their design.

10. The latter approach is, for instance, evident in the regulation and taxation of the freelance sector, which can be used as a vehicle for circumventing some aspects of employment regulation.

3. Getting value for money in regulation

HOW EFFICIENT IS REGULATION?

If part of the purpose of regulatory reform is to maximise the benefits delivered for each pound of cost imposed on regulated parties, then a natural starting point might be to establish and monitor a benefit/cost ratio.

In 2009, this instrument, originally specified as one of the alternatives to Regulatory Budgets (BIS 2008a), was formally adopted by the Government, and it was estimated that the benefit-to-cost ratio of regulations introduced in 2008/9 was about 1.85. The exercise also found that the benefit-cost ratio of secondary legislation was nearly twice that of primary legislation (HM Government 2009c), suggesting that it is easier to improve on the efficiency of existing rules than to optimise new ones.

This figure is, of course, meaningless unless it can be benchmarked appropriately. A comparison with the decade-average ratio in the US, for example, would have found that US federal regulation was 25% more efficient according to even the most conservative estimate.[11] A comparison with the US mid-range estimate for 2008–09 would have put the efficiency gap at 54%. Although these are not like-for-like comparisons, if they do reflect the true regulatory efficiency gap with the US then a regulatory saving of £3.3bn to £7.1bn per annum might be possible without compromising outcomes. Indicatively, either of these estimates would exceed the savings achieved so far under the administrative burdens reduction programme.

As this simple thought experiment illustrates, improving the efficiency of regulation can make a big difference and thus focusing on value for money is a useful approach. However, there are substantial obstacles to be overcome if this is to become a reliable methodology.

First of all, it is only possible to apply such methods to the monetised effects of existing rules. In fact, monetisation and consideration of uncertainty in IA reports still have a long way to go, especially where the benefits of regulation are concerned (NAO 2010). Moreover, the uncertainty tied to cost-benefit assessments is substantial. The long-term experience of the US regulatory review apparatus is that detailed estimates of the benefits of regulation are more than 5 times as volatile as the detailed estimates of its costs (OIRA 2010).[12] Nor is this the fault of UK regulators alone. Even when cost-benefit analysis is implemented well, its methodological shortcomings are substantial and well documented. For some costs and almost all benefits of regulation, price signals are unavailable, the range of potential impacts is limited only by the regulators' imaginations or ad hoc stopping rules, and the choice of discount rates is essentially arbitrary (Ackerman 2008).

Finally, as regulators typically carry out their own Impact Assessments, any quantitative metric will give them an incentive to overstate the benefits of the regulations they introduce and underestimate their costs (Crews 1996).[13] Given the enormous confidence interval attached to estimates of benefits, regulators can almost always ensure that the benefit-cost ratio is at least 1. The need to manage this kind of uncertainty and perverse incentives suggests a role for improved governance structures in Impact Assessment, as well as an enhanced role for business validation and post-implementation reviews.

11. OIRA (2010). The estimated annual benefits of major federal regulations from October 1999 to September 2009 ranged from $128bn to $616bn, while the estimated annual costs ranged from $43bn to $55bn. The estimated benefits for regulations introduced in 2008–9 ranged from $8.6bn to $28.9bn, while the estimated costs ranged from $3.7bn to $9.5bn. The benefit-to-cost ratio could thus vary from 14.3 to 2.3 in 1999–09 and from 7.9 to 0.9 in 2008–9.

12. The range of estimates of benefits of major federal regulations from October 1999 to September 2009 (from $128bn to $616bn) was 131% of the central estimate, while the range of cost estimates ($43bn to $55bn) was only 24% of the central estimate. Note also that, under the most pessimistic scenario, the aggregate cost of major federal regulations would outweigh their benefits in 2008–9.

13. A particularly strong example is the Impact Assessment for the increase in VAT announced in the June 2010 budget, which revised its own adjustment cost estimates downwards partly by discounting 'outliers'.

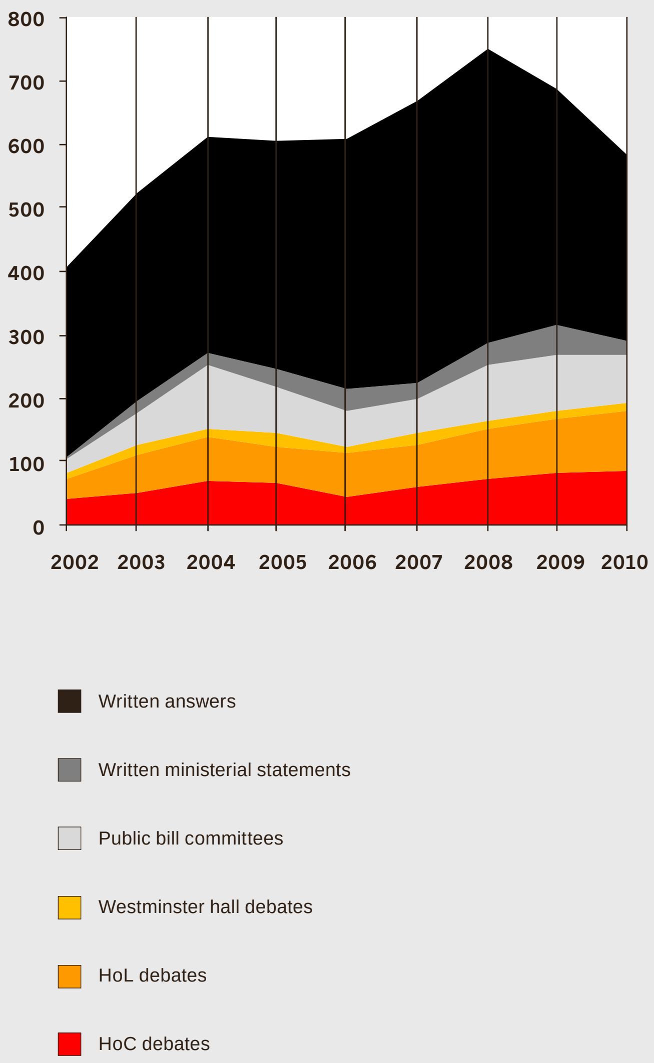
IMPACT ASSESSMENT: FROM APPENDICES TO LIVING DOCUMENTS

Any assessment of value for money relies on robust monetary estimates established through Impact Assessment (IA), but effective and efficient regulation generally relies on a thorough examination of policy options and their respective merits. Despite IA featuring as a key component of regulatory reform since 1998, there is substantial evidence that this crucial tool is still not being used to the extent – or in the manner – intended.

In theory, Impact Assessment is an iterative process which involves making and checking, through consultation, assumptions about what benefits can be achieved through a range of potential policy interventions, at what cost, and what further efficiencies are possible. It begins as soon as a policy challenge is identified, and extends beyond the act of regulating to implementation and the review of regulations. This process can be very difficult to document, but it can be captured to some extent by frequently updated 'living' documents, including IA reports and post-implementation reviews (NAO 2010). In practice, governments around the world, including the UK, view IAs in more static terms. A lot of the time, IAs are mere afterthoughts to the making of rules, which is understood to be the main business of regulation (HoC Regulatory Reform Committee 2008a).

The NAO, for instance, has found that the majority of policy staff and economists in government departments see IAs as irrelevant to policy decisions –their value appears to lie more in formalising and communicating the rationale for regulation and inviting scrutiny or challenge (HoC Regulatory Reform Committee 2008a). Accordingly, a simple search reveals that any references to IAs in Westminster are most likely to be made in written answers and statements, as opposed to debates. This situation does, however, appear to have improved significantly since the regulatory reform boom of 2005 (Figure 2).[14]

Figure 2: References to the phrase 'impact assessment' by place of incidence



Source: www.theyworkforyou.com
2010 estimate is based on extrapolated figures as of mid-July 2010

14. www.theyworkforyou.com. 2010 estimates are based on extrapolated data to mid July.

From a methodological perspective, relatively few IA reports (28% on last count) live up fully to the NAO's standards of good practice, although admittedly standards have improved since new guidance was issued in 2007 (NAO 2009b). The most common shortcomings identified by the NAO and reiterated by the newly established Regulatory Policy Committee (RPC 2010) are as follows.

Monetising the direct and indirect costs and benefits of regulation

Most IA reports now quantify both the costs and benefits of at least the policy-makers' preferred option. The NAO has reported a steady progress in the monetisation of regulatory costs from 2006 to 2009, but has not seen similarly consistent progress in the (admittedly more difficult) monetisation of benefits (NAO 2010).

Considering a wide range of options, including the 'do nothing' option, in an unbiased manner

Almost half of all IA reports still either set out no alternative to the proposed policy, or accept that the alternative is to do nothing, without establishing the baseline costs and benefits of this option (NAO 2010). The lack of a 'do nothing' baseline is crucial as only the costs and benefits incremental to the 'do nothing option' are truly attributable to the policy options being considered.

Planning for implementation and anticipating compliance behaviour

On last count, only 20% of IA reports included an implementation plan, and only one in three made any assumptions about the compliance behaviour of regulated parties (NAO 2009b). If compliance behaviour is not understood, the rate of compliance (and thus the benefits of regulations) will be overestimated and the estimated costs of compliance could prove to be highly unreliable.

Working with European policymakers to integrate the UK and European IA processes

The NAO confirms that the majority of IAs pertaining to the implementation of EU regulation are drawn up with no prospect or intention of influencing the policy-making process in the EU institutions, and the majority do not cite international evidence that might help to check against gold-plating (NAO 2010). Existing guidance continues to treat UK and EU IAs as separate processes (BIS 2007; BIS 2010).

SME testing

Since the new IA guidance was issued in 2007 and the NAO's assessment criteria were tightened, coverage of IAs has been improving, and more than three-quarters of all eligible IAs currently make explicit the anticipated impact of regulations on smaller businesses (NAO 2009b).

Most of the weaknesses highlighted above are understandable considering the resources that regulators must work with and the difficulty of establishing estimates, especially in the case of regulatory benefits. However, there is room for optimism. External scrutiny (whether by the NAO or other stakeholders) is seen by government departments as a key motivation for improving IAs (NAO 2009b); this could mean that at least some of the shortcomings of the IA process are down to surmountable political and organisational constraints.

However, it is clear that one potentially valuable and inexpensive resource is being neglected. The NAO has found that very few IA reports cite academic literature despite an abundance of relevant studies; in fact this is the least common type of documentation used (NAO 2010). Given the superior insights and methodological clarity they can bring to matters of policy, as well as the pressure they are under to demonstrate the real-world impact of their work, academic researchers are extremely under-utilised in the IA process.

THE FLOW AND THE STOCK OF REGULATION

Research has repeatedly found that business perceptions of regulatory burdens are more closely related to the flow of new regulations than the stock of existing ones, and that regulatory uncertainty is a big problem for small businesses (FDS International 2010). This is because businesses must incur substantial costs in familiarising themselves with new regulation, introducing or adapting compliance systems and routines, and taking advice on compliance (BIS 2009g).

Of course, 'stock' and 'flow' are relative terms. Individual regulations can still be new to a business that has never had to comply with them before, and most of the costs associated with new regulation still apply.[15] The best example of this is employment law, of which a great deal is naturally triggered by an entrepreneur's first hire, thus increasing the overall burden of regulation virtually overnight (Cosh et al. 2008).[16] Throughout the lifetime of a business, a number of such regulatory 'bottlenecks' occur when its growth or decisions trigger a great deal of the stock of regulation.

It follows from this analysis that regulatory reform should concern itself primarily with controlling the flow of regulations. Existing regulations, on the other hand, are better dealt with through thematic reviews focused on regulatory bottlenecks. Good practice in the area of thematic reviews has been established by the Australian Government in their recent *Review of Subordinate Legislation* (Bishop 2009), and the European Commission has also in the past had some success in identifying and exploring 'stress points' in business growth (European Commission 2005).

CASE STUDY: THE 'ONE-IN, ONE-OUT' RULE AS A VALUE FOR MONEY TOOL

A relatively simple proposal for improving the efficiency of regulation is to tie the introduction of new rules to the simplification or removal of existing ones of roughly equal impact. The 'one-in, one-out' rule acknowledges the regulatory impetus of governments, and can be enforced through relatively simple governance structures. Additionally, policy-makers can use it to reduce the burdens of regulation, by requiring that the monetary value of simplifications exceed that of new regulations by a certain percentage.

Our concerns regarding measurement and perverse incentives apply to this control mechanism as they do to all controls focused on the arithmetic of regulation. However, 'one-in, one-out' arrangements have an additional problem in that they positively encourage regulatory churn. The government may rest content that it is decreasing the overall regulatory burden in introducing a new regulation, but in fact it is likely to be doing the opposite by making the regulatory framework more volatile. Research by the IoD suggests that new regulations are more salient, and thus more damaging to business confidence and perceptions, than existing regulations considered for simplification (IoD 2008). More importantly, the costs of familiarisation and systems adaptation apply to simplifications just as much as they do to new regulations. Therefore, absent any regulatory innovation, a one-in, one-out rule will almost certainly fail to improve perceptions of regulation.

The advantage of such rules, however, might be that they encourage regulatory innovation by forcing regulators to look for savings. While it is not particularly easy to test this hypothesis, the NAO's research into the Administrative Burdens Reduction programme suggests that two-thirds of the savings achieved during the first half of the programme were based on decisions that predated the programme itself (NAO 2008). This means that, even in the early days, when 'low-hanging fruit' were in abundance, departments were largely unable to achieve much regulatory innovation. Considering the amount of political capital invested in the Administrative Burdens Reduction programme, future governments may struggle to improve on this record.

15. Presumably, external specialists will be familiar with established rules and the cost of their advice may well be lower. However, as the Forum of Private Business found, external advice only accounts for just over a quarter of SME compliance costs.

16. On a scale of 1 to 10, the average rating of regulation and tax as a business problem was 3.3 among non-employers, against 4.3 among SME employers.

FALSE BURDENS, FALSE SAVINGS

Not all costs incurred in the process of compliance are the same. Often, regulation serves to codify good practice which businesses, once engaged, would maintain even in the absence of a formal obligation. The cost of undertaking these activities is not a product of government coercion, and therefore does not constitute a regulatory burden. As the European Commission put it:

> *'Pure' obligation refers to what one would stop doing if the legal obligation was removed.... By contrast, some requirements set by law correspond to what an entity would normally do. Properly managed enterprises would have an accounting system, even in the absence of legal bookkeeping obligations.* (European Commission 2008)

In the UK context, PwC, who led the original Administrative Burdens Measurement Exercise, also noted:

> *It is important to recognise that the SCM* [Standard Cost Model] *provides an estimate of administrative costs of which administrative burdens are a part. The costs of some activities that business...would carry out regardless of regulatory requirements (business as usual costs) may be included. To ensure that effort is focused on areas that business will feel the most benefit from,* [the Government] *will need to consider how to take into account business-as-usual costs in setting targets based on the estimates generated using the SCM.* (PwC 2006)

Regulated parties are always on the lookout for ways of reducing their compliance costs, whether by using better administration technologies or by changing their work processes. When compliance costs are reduced in this manner the reduction cannot be attributed to regulatory simplifications and does not constitute a true saving.

Assessing what businesses might do if they were not coerced, or how they might adapt to regulatory requirements, is a key function of Impact Assessments, and can be approached through consultation, statistical modelling or pilot testing. Even then the answers should not be considered final; rather, they should be reviewed post-implementation, and estimates of regulatory costs and burdens adjusted accordingly. This testing of assumptions is equally important when considering regulations for simplification. There is evidence, for instance, that the adaptive capacity of businesses can be underestimated by policy-makers, inflating the estimated costs of regulation (Heinzerling and Ackermann 2002). Similarly, there is evidence that regulation can have strong enabling and motivating effects on regulated parties which can be easily discounted by more naïve analyses of cost and benefit (Anyadike-Danes et al. 2009).

CASE STUDY: THE EMPLOYMENT LAW GUIDANCE PROGRAMME

In 2008, BIS commissioned ORC International to conduct a study of the administrative cost of complying with employment regulation (Lambourne et al. 2008). BIS' intention was to compare the ORC findings with those of the benchmark study of administrative costs carried out in 2005 (PwC 2005), in order to establish the impact of its Employment Law Guidance Programme.

The survey of 2,000 employers found an overall saving of nearly £400m (in constant prices) relative to the benchmark study. The authors noted that the reported cost reduction was:

> *due to a combination of factors, including: different data gathering methods, different sample sizes and spread; changes in regulation; and changes in business behaviour and change in economic climate.* (Lambourne et al. 2008)

Yet BIS attributed all £400m of savings to the Employment Law Guidance Programme, implying that the guidance had brought about savings of 41% relative to the baseline, even though only about a quarter of the sample had used any one of the guides in question and no single component of the guidance had been used by more than 9% of the sample.

Despite the fact that an External Validation Panel including most major business organisations was meant to challenge all alleged savings, the estimate derived from the ORC study was immediately included in the Government's report of December 2008. This accounted for 21% of all reported net savings from the beginning of the Administrative Burdens Reduction Programme to that date (BRE 2008).

BEYOND RED TAPE: THE POLICY COSTS OF REGULATION

Much of the Better Regulation agenda so far has focused on reducing red tape. There are three simple reasons for this. First, measuring administrative burdens is a much simpler task than the measurement of other regulatory burdens. Second, such measurements can be standardised under the Standard Cost Model (SCM) methodology. Finally, cutting administrative burdens is less politically sensitive as it does not at first glance appear to reduce public protection.

However, there is clear evidence that the administrative burden of regulation can be reduced, as indeed it has been in the UK, without improving perceptions of regulation (FDS International 2010). This is primarily because administration represents less than one-fifth of the total costs of regulation.[17] Moreover, administrative costs are mostly incurred up-front and thus the potential for subsequent savings is not very great. These facts suggest a need for policy-makers to focus on reducing policy costs: the wider economic effects of behaviour mandated by regulation.

Unfortunately, a programme for reducing the policy costs of regulation cannot mirror the stock-taking approach of the Administrative Burdens Reduction programme. The only possible counterfactuals to the total stock of regulation in the UK would be a) zero regulation, b) the current stock of regulation in a comparator country, or c) the stock of regulation in the UK at an earlier date.

17. In 2005, the total administrative burden of regulation was calculated at £13.4bn, while the IoD estimated the total cost of regulation at about £80bn in 2009. Adjusting for CPI and a 25% net reduction, this suggests that administration currently costs £11.1bn which accounts for 13.9% of the total costs of regulation.

Of these options, a) would be meaningless[18] and b) would be fraught with methodological challenges.[19] The final option, c) is less problematic, but is essentially equivalent to a review of the flow of regulations during a range of dates in the past or future. Medium-term schedules of regulatory activity, such as the recently established Forward Regulatory Programme, can invite scrutiny and provide a basis for such reviews. This would require a detailed accounting of the expected benefits of regulation, which could be modelled after Public Service Agreements (PSAs), in addition to an analysis of costs.[20] This is also a reasonable approach, considering the fact that the cumulative effect of regulations on business is more important than their individual effects (FDS International 2010).

18. A completely unregulated society would be unable to sustain almost all of the types of enterprises and markets that are currently subject to regulation.

19. A valid comparator would have to be a large EU country with legal traditions similar to those of the UK – of which there are none.

20. Apart from ACCA, this view was also expressed in responses to the BRE Consultation on Regulatory Budgets by ABTA, the BCC, the Chemical Business Association (CBA), the Confederation of British Industry (CBI).

BETTER REGULATORS

At the heart of regulatory reform is the ability of regulators to understand regulated parties and the risks their activities pose to the public and deliver innovative solutions. According to the NAO's latest survey of business perceptions of regulation, only 28% of businesses believe that the government understands businesses well enough to regulate; a figure virtually unchanged since 2007 (FDS International 2010).

In fairness, the market for regulatory management training has yet to attain critical mass, and thus this training may not be relevant or cost-effective enough for all regulators. However, there are substantial issues with demand for such training as well; most notably the emphasis on learning simply the standardised tools of regulatory reform, such as SCM. This in turn is the case because training is driven by process and not by a thorough assessment of regulators' skills needs (Radaelli 2008).

In 2008, the House of Commons' Regulatory Reform Committee (2008a) expressed concern that regulatory reform is not as embedded or valued a part of the civil service career path as it ought to be. As the regulatory reform agenda becomes ever more ambitious, these skills gaps will become increasingly problematic and the resulting reliance on a small team of regulatory reform 'champions' may not remain viable for much longer (NAO 2008). The Government's complementary use of private sector expertise, for instance in auditing regulatory savings through the BRE External Validation Panel, is of course laudable. But ultimately progress in regulatory reform must come from better regulators, equipped with the right skills and an appreciation of the realities of business life.

Given these limitations, and the UK's status as a leader in regulatory reform, those involved in the UK's Regulatory Reform agenda may have no option but to learn on the job. In a comparative study, Radaelli (2007) finds some weak evidence of the kind of learning that makes regulators truly 'better' in the UK – which is still a better result than those achieved by regulators abroad. For the most part, however, regulators are engaged in political and social learning – replicating models such as SCM or working out how to manage the political consequences of the Regulatory Reform agenda. The absence of provision for trainers of regulatory management adds further to this limitation (Radaelli 2008).

4. Managing regulatory cross-subsidies

SOME SIMPLE ARITHMETIC

When the Better regulation Executive (BRE) consulted on Regulatory Budgets in 2008, one of the most popular suggestions from stakeholders was that, since any regulation whose benefits outweigh its costs is 'good', the government should not set a target for the total cost of regulations but rather for their net benefits (BIS 2008b; 2009e).

Both net benefits and the benefit–cost ratio, however, rely on the assumption that regulation creates no cross-subsidies: ie that regulated businesses enjoy all the benefits of regulation themselves, or that all regulatory costs incurred in the interest of consumers are passed on to them via higher prices. However, as we have seen, cross-subsidies are inevitable. Businesses are often subject to regulation that provides them with scant benefits, while small businesses in particular are rarely able to pass on higher costs to customers. Such cross-subsidies are almost entirely unaddressed by current structures in Better Regulation.

As Table 4 illustrates, if policy-makers wanted to increase the benefit-cost ratio of regulation from the current level of 1.85 to, for example, 2, they could achieve this at various levels of cross-subsidy – but would almost certainly achieve a higher net benefit at higher rates of cross-subsidy. One way of addressing this type of perverse incentive would be to complement the benefit-cost ratio with a measure of the extent of cross-subsidy (Table 4).

The choice of cross-subsidy ratios is of course political, but the methodology itself is not; what is important is that the level of cross-subsidy is taken into account when the net or relative benefits of regulation are considered. In the example featured in Table 4, Option B is clearly preferable to Option C despite a higher cost for business, as it delivers a higher net benefit with the same level of efficiency and business cross-subsidy; although whether it is also preferable to Option A is a matter of political preference.

Complementing value-for-money assessments with a cross-subsidy ratio presents a simple and effective substitute for a budget constraint. One of its great advantages is that it allows government to monitor tradeoffs for any particular group – from small businesses to third-sector organisations or local government, as long as the costs and benefits of it can be identified in Impact Assessments.

Even these improvements still might not address the full issue of sustainable tradeoffs. The arithmetic of Better Regulation tends to be based on Equivalent Annual Cost (EAC), which converts the string of uneven annual costs of regulation into a series of equal annual flows. In fact, early costs of regulation are almost always higher, which means they need to be monitored separately to ensure the absorption capacity of regulated parties is not overstretched.

While consulting on a possible system of Regulatory Budgets, the BRE heard that it is impossible to know what the absorptive capacity of regulated parties actually is (BIS 2008b). This argument is problematic in that some kind of industry can exist under any kind of regulatory regime. An over-regulated industry can still grow briskly under the right circumstances but will almost certainly be characterised by abnormal levels of market concentration, low entry or exit rates, low levels of innovation or a high degree of informal activity (Broersma and van Ark 2004). At any rate, as with tax, the objective of government should not be to exhaust the capacity of regulated parties but rather to manage it so that the combined benefits of economic activity and regulation can be maximised.

Table 4: Benefit-to-cost ratio: an illustration with different levels of cross-subsidy and net benefits

Option A	Cost	Benefit	Net benefit	Benefit-to-cost ratio	Costs without cross-subsidy (benefits/BCR)	Cross-subsidy (benefits/BCR - costs)	Cross-subsidy, as multiple of cost
Consumers	50	1,350	1,300	27	675	625	12.50x
Businesses	500	50	-450	0.1	25	-475	-0.95x
Public sector	150	0	-150	0	0	-150	-1x
Total	700	1,400	700	2	700	0	

Option B	Cost	Benefit	Net benefit	Benefit-to- cost ratio	Costs without cross-subsidy (benefits/BCR)	Cross-subsidy (benefits/BCR - costs)	Cross-subsidy, as multiple of cost
Consumers	50	700	650	14	350	300	6x
Businesses	250	100	-150	0.4	50	-200	-0.8x
Public sector	100	0	-100	0	0	-100	-1x
Total	400	800	400	2	400	0	

Option C	Cost	Benefit	Net benefit	Benefit-to-cost ratio	Costs without cross-subsidy (benefits/BCR)	Cross-subsidy (benefits/BCR - costs)	Cross-subsidy, as multiple of cost
Consumers	50	400	350	8	200	150	3x
Businesses	125	50	-75	0.4	25	-100	-0.8x
Public sector	50	0	-50	0	0	-50	-1x
Total	225	450	225	2	225	0	

CROSS-SUBSIDIES IN PRACTICE: THE MANAGEMENT OF PUBLIC RISK

In one way or another, businesses will always expose the public to some level of risk. Customers and employees choose, to some extent, to tolerate some risk which they price into their demand for goods and services or their supply of labour. However, asymmetries of information or bargaining power mean that businesses can reallocate risks to the detriment of other parties, without compensating them. Such market failures must be addressed through regulation.

In order to do this, policy-makers need to identify and measure the risks to which parties are exposed based on robust evidence, so that they can prioritise the areas where regulation can make the most difference and decide on an appropriate level of intrusiveness for rules and enforcement. This is known as the 'risk-based' approach to regulation. Despite strong criticism in the aftermath of the financial crisis of 2008–09, the Regulatory Reform Committee recently offered a qualified defence of risk-based regulation:

> *Risk-based 'right-touch' regulation remains a valid approach provided there is: (a) diligence in understanding risk; (b) a willingness to accept some degree of failure (albeit that in certain sectors there must be maximum effort to eliminate failure); (c) an awareness that risk assessments, with their tendency sometimes to lead to a false sense of security, should be subject to appropriate challenge; and (d) the willingness to be intrusive rather than light-touch when appropriate.* (House of Commons Regulatory Reform Committee 2009)

In this context, it is hard to dispute the basic concept behind the establishment of the Risk and Regulation Advisory Council (RRAC): that a better understanding of public risk by all parties can both reduce the burden and improve the outcomes of regulation (Better Regulation Commission 2008). Both the Regulatory Reform Committee and the OECD have since acknowledged that the RRAC has established a credible approach to understanding public risk (HoC Regulatory Reform Committee 2009; OECD 2009a), based on the following principles.

- Understanding the risk in context – getting to the bottom of how perceptions of the risk have been shaped, and mapping the landscape around the risk.

- Engaging with a broad community – actively engaging the many different groups of people who have an interest in the issue and its outcomes, from an early stage, using the map of the risk landscape to develop a common understanding of the issues and to explore together how the issues can be tackled.

- Effective communication – quickly restoring focus to the underlying nature of any given risk, provoking public debate about interventions and tradeoffs (RRAC 2009b).

With the RRAC's approach to public risk now fully developed and receiving wide acclaim, it is not clear how further propagation of public risk think-tanks will be of help to anyone. The previous government correctly identified this issue in its response to the RRAC's final recommendations (BIS 2009d). The priority now should be for the RRAC methodology to be embedded where it belongs, within government departments and regulators. In 2009 the RRAC issued practical guidance for policymakers, which could be particularly helpful in this undertaking (RRAC 2009b).

Finally, it is important to note that, although risk can be measured to some degree of objectivity, the tradeoffs between public risk and public benefit (and, by implication, the extent of regulatory cross-subsidies) are ultimately resolved by weighing the preferences of one part of society against those of another. This is a purely political act, one which cannot be delegated to independent third parties.

STRENGTHENING THE VOICE OF END-USERS

Few relationships are as thoroughly regulated as those between consumers and retail providers of goods and services (Cosh et al. 2008),[21] because consumers are subject to information asymmetries and the risk of negative outcomes is substantial. The case for protecting consumers applies equally well to small, owner-managed businesses: with few resources or expertise and little bargaining power, these are subject to information asymmetries in much the same way as individuals (ACCA 2009a).

Simplification of products and regulatory reporting (Sunstein 2010), as well as consumer education and support (ACCA 2009a) are key to improving regulatory outcomes for end-users. The BRE's research has found that excess or complex information can lead to poor outcomes for unsophisticated end-users (BRE/NCC 2007), while it is also known that consumer education and support, as opposed to more information, can improve end-users' confidence and help mitigate information asymmetries (OECD 2009b).

Government policy aside, ACCA has argued repeatedly for the enhanced representation of the end-users of regulated goods and services (namely consumers and owner-managed businesses) in the regulatory process. This is necessary not only at the institutional level, where the many disparate consumer groups with their limited resources can often make little difference to regulation, but also at the personal level. This conviction is shared by the House of Commons Regulatory Reform Committee, which has argued for consumer representation on the Regulatory Policy Committee (RPC), and improved ties between consumers and the BRE (HoC Regulatory Reform Committee 2009). In light of all of this, it is disappointing that the most recent consultation on the powers of a Consumer Advocate in 2009 still proposed to limit the definition of 'consumers' to individuals (BIS 2009f).

21. The survey found that SMEs in distribution sectors reported a higher regulatory burden, as did more specifically those in retail and the hotel and restaurant industries.

5. Towards a value-adding regulatory services industry

WHAT IS THE REGULATORY SERVICES INDUSTRY?

The term 'regulatory services industry' is derived from the literature of the LBRO, in which context it refers to local authority regulatory services (LARS) (Tiessen et al. 2009). However, a more appropriate concept would encompass regulatory advice and guidance, support and enforcement – all of the private and public services that shape the implementation, and thus the costs and benefits, of regulation.

In a true regulatory services industry, central government and regulators are natural wholesalers. Like most wholesalers, they can and often do decide to move downstream to the distribution of regulatory services through business support services, regulatory guidance and the regulatory functions of local government. In so doing, government competes with a multitude of private sector providers: accountants, lawyers, consultants, business representative bodies and networks. For the most part, government competes well as a provider of information, but less well as a provider of advice (Richard 2008).

UK SMEs spend £2.6bn annually on purchasing regulatory advice from the private sector. Like all regulatory costs, this falls disproportionately on the smallest businesses, but the distribution is more skewed than in the case of internal compliance costs. Micro enterprises spend 10 times as much per employee and 12 times as much per pound of turnover on external advice than medium-sized enterprises. However, it is small businesses (with 10 to 49 employees) that source most of their regulatory advice externally (Forum of Private Business 2009): although the needs of micro enterprises might be greater, access to external advice is constrained by their financial resources.

As the Anderson Review of Regulatory Guidance heard[22] in 2008, retailers of regulatory services need to offer a number of features in order to be able to provide credible advice on regulation:

- Professional skills, standards, knowledge and experience (NAO 2009a).[23]
- Sharing of risk with the end-user of guidance, often with the added protection of professional indemnity insurance (FDS International 2010).[24]
- An ongoing relationship with the end-user and an understanding of the individual business so that guidance can be put into context.
- An account management approach, including a single point of contact, a tailored offering and continuity of service. This can be particularly problematic as 40% of businesses (down from 45% in 2007) do not believe the government takes a joined-up approach to regulation (FDS International 2010).
- Multiple distribution channels, including but not restricted to face-to-face advice.
- Provision of services concurrent with the actual daily schedule of business, with guidance available after hours.

22. These points were all raised at a Stakeholder Consultation Event (BIS 2008b) aimed at validating the findings of the *Anderson Review of Regulatory Guidance* (BIS 2009c). The retail vs wholesale guidance argument was not made by ACCA and was marginal to this discussion, however it is highly consistent with ACCA's views.

23. The NAO's research confirms these as the most important reason for engaging external regulatory consultants among SMEs.

24. Compared to the 2009 survey (discussed above) the 2010 survey specified further the impact of perceived professionalism on perceptions of regulatory adviser and found that a need for assurance and independence were the foremost reasons for engaging an external adviser.

The fact that total spending on government funded-business support comfortably exceeds the value of the entire UK market for private sector business support[25] suggests that the cost of building this 'retailer' capacity in or through the public sector can often exceed the cost assumed by business in directly seeking out private advice. It is only where this is not the case, and there is evidence of market failure that genuinely justifies intervention, that government should try to compete with private advice by establishing new support structures.

Most importantly, in a true regulatory services industry, regulators and advisors ought to think of and market their services as a value-added service to the business community. The more regulators are seen to emphasise fact-finding, support, capacity building and accreditation above inspection and sanctions, the sooner negative perceptions of regulation, some of which are not entirely justified (NAO 2009c), can be laid to rest.

This service-driven approach is not as far from reality as it may appear: research for the LBRO has documented the substantial advisory function of inspectors and other regulatory professionals in the public sector (Tiessen et al. 2009), while the Anderson Review has called for them to be upskilled to sector specialists (BIS 2009c). The LBRO has duly considered approaches, such as the Retail Enforcement Pilot (REP), for the integrated delivery of regulatory services through a minimal number of cross-disciplinary inspections. These early trials have shown that integrated delivery has the potential to save businesses time, money and distraction while improving regulatory outcomes (Peck et al. 2009). The LBRO also found, however, that moving to such models of delivery will require a change of culture and a robust commitment to professional standards (Page et al. 2010).

ACCOUNTANTS AS PROVIDERS OF REGULATORY SERVICES

Evidence suggests that accountants are the professional advisers of choice for SMEs, both in the UK and abroad (Blackburn and Jarvis 2010) and regulatory advice makes up much of their offering. Recent research for the NAO found that over half of the UK's SMEs (57%) use external accountants specifically for help complying with regulation, making the profession easily the most popular regulatory advisers for smaller businesses (FDS International 2010). In addition to these, SMEs often engage their own in-house finance staff in regulatory compliance. The Forum of Private Business found in 2009 that finance staff had responsibility over compliance in nearly a third (30%) of micro and small enterprises in the UK (Forum of Private Business 2009).

Typically, an external accountant will be called in to deal with a simple issue of financial management or relatively low-value added compliance tasks such as tax administration. This type of work can give accountants privileged access to information and insights about the business, and, provided they can demonstrate technical competence, professionalism and empathy, a bond of trust is likely to develop between them and the business owner/manager. This often allows accountants to expand their offering beyond financial management (Blackburn et al. 2010) and it is evident that regulation is by its nature one area to which the skills and networks of professional accountants are particularly applicable.

It is a little-appreciated fact, for instance, that micro enterprises (businesses with 1 to 10 employees) are more likely to turn to their accountant for help with employment law and regulation than any other private or public sector adviser (Lambourne et al. 2008). The number of employers using accountants for advice in this area has been on the rise for years, from 14% in 1998 to 19% in 2004 (Kersley et al. 2006) and 20% in 2008 (Lambourne et al. 2008). The alternative models of provision of HR and employment law advice by small and medium-sized accountancy practices (SMPs) should be of particular interest to policy-makers, because they illustrate how trusted business advisers can carve out niches in the regulatory services industry (Jarvis and Rigby 2010).

25. For comparisons, see ACCA (2009d), and BRE (2007).

The smallest and more cautious practices dispense advice on procedures and contracts based on their own experiences and templates (the 'minimalist' model). Their advice is essentially passive, driven by the feeling that they need to be helpful to be competitive and keep clients, and they are quick to refer clients on for more specialist advice. Practices of middling size (4–10 partners) are more likely to develop a more active HR role arising out of payroll activities (the 'payroll model'), which they are keen to develop as an income stream or a means of cross-selling. Larger practices may employ qualified HR staff (the 'qualified HR model'), with the aim of acting as a one-stop-shop for business advice, taking advantage of more traditional practitioner/client relationships to develop the HR area.

UNDERSTANDING COMPLIANCE

Compliance with regulation cannot always be taken for granted, and even in the case of compliant businesses it is not a straightforward affair: research carried out for the Anderson Review of Regulatory Guidance suggests that the compliance behaviour of some 42% of SMEs will not fit a standard model (Ipsos MORI 2008).[26] Because compliance behaviour and resources define the costs of and benefits from regulation to a great extent, this understanding is crucial to the analysis of costs and benefits. Unfortunately a large percentage of UK businesses (58%) do not believe that the government understands business well enough to regulate (FDS International 2010). While this is a disappointing figure, it also reflects a steady improvement since 2007 (when 68% of business expressed the same view).

One obvious area for improvement is Impact Assessment, with only about a 20% of IA reports including an implementation plan (NAO 2009b). In addition to enhanced implementation planning, regulators should take advantage of recent improvements in consultation guidance and particularly the 4,000-strong Small Firms Consultation Database. This has seen substantial use so far (for example, in consultations on EU regulations on biocides and insurance contract law in 2009), and should be further publicised as an effective way for regulators to source grassroots information from SMEs.

As the Regulatory Reform Committee has acknowledged, grassroots information is extremely important to the cause of regulatory reform (House of Commons Regulatory Reform Committee 2008a). Because the business population is incredibly diverse, regulators can lose sight of crucial patterns when relying on aggregated figures and insights; similarly, reporting outcomes against aggregates can also be misleading (ACCA SME Committee 2009a). Government must avoid the temptation to use such channels solely for the purpose of 'celebrating success' (House of Commons Regulatory Reform Committee 2008b) and actually use them to test assumptions and create 'bottom-up' regulations.

Post-implementation reviews of regulation can be one particularly valuable tool for regulators. The recent experience of RPC scrutiny has shown that real-time review of regulation is not always an option: in the first half of 2010 it was only able to issue an opinion on about 11% of all eligible regulatory proposals (Regulatory Policy Committee 2010). But more importantly, reviews allow regulators to test their assumptions on compliance behaviour and learn valuable lessons. Unfortunately, only one in three IAs make provision (Regulatory Policy Committee 2010) for post-implementation reviews, and only about half of all the regulations for which a post-implementation review is promised ever receive one. This percentage may be low, but it compares very favourably to the 5% rate of spontaneous post-implementation review among regulations for which none has been promised. This suggests that commitments to the review of regulations do motivate policy-makers to some extent (NAO 2009d).

Beyond such commitments, some additional motivation can be created through sunsetting clauses, which could trigger more post-implementation reviews. Contrary to the hopes (or fears) of some stakeholders, the available evidence suggests that sunset clauses do not in themselves make it more likely that a 'poor' regulation will be repealed (Wegrich et al. 2005), but this objective may in fact be less important than that of improving the understanding of regulators.

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26. This percentage is based on a statistical classification of SMEs and includes all SMEs except those classified as 'capable but unconcerned' and 'prepared and established', whose compliance behaviour is considered predictable as it is unconstrained by the adequacy of internal resources.

6. Measuring progress in regulation

THE CASE FOR OUTCOME-BASED MEASURES

Section 1 has already discussed the frustrating lack of any correlation between regulatory cost savings and overall business perceptions of regulation, and section 3 has examined the shortcomings of the impact assessments these estimates are ultimately derived from. However, there is also a good deal of evidence that quantitative, output-based measures of regulatory reform, such as administrative cost savings, have in themselves substantial limitations.

Numerical measures based on the ubiquitous standard costs model (SCM) are rarely statistically robust or based on representative samples (Cavallo et al. 2009; NAO 2008). This has, at times, made independent researchers used by the government uncomfortable, as in the following passage from the ORC report into employment law guidance:

> *Calculations for upholding a withdrawal of an appeal for a refusal for flexible working and for withdrawing an application on the grounds of poor employee behaviour were reliant on fairly small sample response levels of 7 and 6 respectively. Whilst this is acceptable in the SCM methodology, findings should be treated as indicative only.* (Lambourne et al. 2008)

Even national statistics, the most quality-assured part of these estimates, can be very unreliable at the high levels of detail often required by regulators. Since 2005, the Office for National Statistics (ONS) has not been allowed to suppress unreliable statistics as a consequence of the Freedom of Information Act, and thus statistics can be published based on as few as four observations (ONS 2009). Users of detailed national statistics are rarely aware of the confidence intervals attached to these, and are very unlikely to cite them in their estimates (ACCA 2009b).

Using output-based targets for regulatory reform becomes more problematic in the absence of consistent measurement methodologies across departments, as aggregate measures of savings can be even less meaningful than the item estimates they are based on (NAO 2008). Moreover, as with all targets, such output-based measures can create perverse incentives among civil servants and ministers, who can pursue their respective targets at the expense of true improvements in the business environment (Crews et al. 1996).

Finally, it is important to remember that the link between regulatory cost savings and desirable outcomes – from GDP growth, to employment or business survival – is either tenuous or extremely complex, as the properties of regulations do not directly determine their impact on businesses (see Sections 2 and 5).

ACCA does not advocate a retreat from such measurements. We recognise their value as a tool to focus the minds of regulators and reformers. We also appreciate – being an accountancy body – that what gets measured gets done, and that the processes underlying regulatory reform certainly require careful monitoring. However, policy-makers need to stop using such measures as evidence of improvements in the regulatory environment and relegate them to their proper function – that of internal evaluation and progress reporting tools.

In late 2008, the ACCA SME Committee called for the current output-based system for evaluating regulatory reform to be replaced by one based on outcomes (ACCA SME Committee 2009b), changes in the behaviour of businesses and individuals that are attributable to regulation. The SME Committee recommended four broad areas for consideration: Employment, Investment, Innovation and Enterprise.

Unlike outputs, outcomes are much simpler and cheaper to establish, because they are widely targeted by existing surveys administered by the government and the private sector (BIS 2009a).[27] They are also more intuitively appealing to a wide range of stakeholders and can be clearly linked to political priorities, ensuring that what are in effect political decisions remain with elected representatives. Finally, outcomes can be clearly linked to the consultation, impact assessment and post-implementation review processes, offering regulators a simple but effective framework for considering the costs and benefits of specific regulations.

27. BIS ran 47 regular surveys and 11 ad hoc surveys in 2008/9, at a combined cost to businesses and the taxpayer of £3.5m.

TOWARDS AN OUTCOMES-BASED REGULATORY SCORECARD

An outcomes-based instrument for assessing the health of the UK's regulatory system would bring together a small number of survey-based indicators, summarising the effects of the regulatory environment on business and the wider public. Policy-makers could, in time, construct such an instrument fairly simply, provided they adhere to the following principles.

- No outcomes should be measured on the basis of emotionally loaded surveys (eg surveys of 'barriers' to business growth) or surveys about regulation.[28]

- All outcome indicators should be drawn from the largest and most up-to-date independent surveys available, but preferably existing ones.

- Indicators should be comparable across as much of the UK's peer group as possible and should be obtainable, where applicable, for businesses of different sizes in order to allow for appropriate benchmarking (see Table 5).

- To ensure a balanced view, indicators should be available for the positive as well as the negative effects of regulation (see Table 6).

- Changes to the outcome indicators should correlate with changes in headline perceptions of regulation – in the long run, indicators should be dropped from the scorecard if no such correlation exists.

28. For a discussion of how such measures can bias assessments of regulatory quality, see M. Anyadike-Danes et al. (2009).

Table 5: Sample indicators for a regulatory scorecard – Enterprise

Enterprise indicators	UK	EU	UK t-1	EU t-1	Source	Latest survey	Freq.	Breakdown by size?	Internationally comparable?
% of working age population who do not believe self-employment is feasible and cite regulatory constraints as a reason	0%	4%	2%	7%	Flash Eurobarometer Survey on Entrepreneurship	2009	2 yrs	N/A	EU-27 EFTA, Croatia, Turkey, US, Japan, South Korea, China
% of working age population who prefer to be employees and cite fear of regulation as a reason	3%	5%	7%	7%					

Table 6: Sample indicators for a balanced regulatory scorecard – Innovation

Innovation indicators	UK	EU	UK t-1	EU t-1	Source	Latest survey	Freq.	Breakdown by size?	Internationally comparable?
% of businesses citing domestic regulation as a 'high' barrier to innovation	8%	N/A	7%	N/A	Community Innovation Survey	2009	2 yrs	YES	EU-27
% of businesses citing EU regulation as a 'high' barrier to innovation	7%		6%						
% of businesses citing environmental regulation as a trigger for innovation	34%	35%	N/A	N/A	Innobarometer Survey	2009	2 yrs	YES	EU-27
% of businesses citing other regulations as a trigger for innovation	34%	30%							

7. Conclusions and recommendations

THE STATE OF PLAY

The UK is a global leader in regulatory reform and one of the best places in the world in which to do business. Nevertheless, the Better Regulation agenda as currently understood has reached a plateau. Since the policy boom that kick-started it in 2005, it has made a great deal of progress in terms of methodology and political learning, and has delivered on most of its explicit objectives – providing a good return on the millions of pounds invested in it. However, the approach to Better Regulation in the UK is still far from joined up, and the programme has achieved little in terms of improving businesses' perceptions of regulation.

Pursuing Better Regulation in its current form will become increasingly difficult, not only because of a lack of results on the ground, but also because the financial crisis of 2008–9 and its legacy of fiscal contraction have called the entire project into question, and made regulation much more attractive. Better Regulation will need a substantial change of narrative, as well as new tools, if it is to deliver any further results.

In our view the Regulatory Reform agenda is not going through a mid-life crisis, as some scholars have suggested, but is only just coming of age. Champions of Better Regulation are increasingly frustrated because they have chosen to take on the intractable, 'wicked' problem of bad regulation. This approach has severe limitations and can lead to contradictory actions as different stakeholders vie for influence over government policy. Government should prepare for the probability that it will never be able to transform Better Regulation into a 'tame' problem by design (or, worse, by definition).

FIRST PRINCIPLES

Regulation mirrors taxation and thus appropriate institutions and tools for regulatory management can be adapted from the tried and tested toolkits of tax and fiscal management. Governments have acknowledged for some time that regulation of any business activity should be undertaken only in the pursuit of explicit and clearly defined benefits that have been shown to outweigh its costs. But a mature regulatory reform system should also have three overarching objectives.

- Maximising the public benefit gained for each unit of cost imposed on regulated parties.
- Ensuring that regulatory cross-subsidies and risk-sharing are fair and sustainable.
- Ensuring that the regulatory services industry adds genuine value to both regulated parties and the wider public.

These in turn originate from a small number of tax-inspired principles of good regulation.

- Accepting legal management of regulatory costs/rejecting non-compliance.
- Maintaining regulatory costs at a sustainable percentage of GDP.
- Ensuring that changes to regulatory frameworks are minimal and predictable.
- Non-discrimination, no hidden regulatory subsidies, meaningful consultation.
- Clarity regarding the boundaries of regulatory cost management and non-compliance; differential treatment of the two.
- Levels of regulatory protection that maximise welfare in a global, competitive context, and are calculated to avoid retaliatory measures.
- Efficiency of compliance for regulated parties and of enforcement/implementation for government.

- Periodical reviews of the stock of regulation and sunsetting of regulations and regulators.
- Clear link between compliance with and outcomes of regulation; no regulatory proposals without appropriate impact assessment.
- Avoidance of multiple information requests and multiple standards of compliance.
- Respect for the rights to privacy and property.
- Admissibility of social as well as economic regulatory outcomes, as well as regulatory subsidies that maximise long-term welfare.

All this will rely on regulators thinking small first. A realistic approach to regulating businesses must acknowledge that the vast majority of them are very small. It should acknowledge the limited impact and resources of smaller businesses not by making ad hoc adjustments to regulations built for large corporates, but by developing rules in a 'bottom-up' fashion.

VALUE FOR MONEY

Improving the efficiency of regulation could produce savings at least comparable to those produced by the Better Regulation agenda so far. This theme in regulatory reform, naturally the domain of civil servants, is the best developed, but its governance is as yet incomplete. It should ideally be led by an independent body reporting to Parliament, mirroring the role and resources of the NAO; resources in particular are an issue for current arrangements such as the RPC. In future, the BRE needs to formally assume leadership of the value for money agenda, become appropriately resourced for it, and gradually achieve greater independence.

Reform must acknowledge the cumulative effect of regulation on businesses, especially smaller ones. It should move away from administrative burdens reduction and prioritise the flow and policy costs of regulation. This can be done by firmly establishing a medium-term planning and review cycle, building on the Forward Regulatory Programme format, and a programme of thematic reviews of regulation focused on regulatory 'bottlenecks' such as taking on one's first employee. Additionally, there is a need for greater rigour in the measurement and communication of regulatory benefits. This is not simply a matter of getting the numbers right but is crucial to the legitimacy of the Regulatory Reform programme. A solution based on the existing PSA format must be considered.

Impact Assessments are central to the cause of value for money in regulation, yet they are still seen as perfunctory or as a standardised means of justifying decisions. Fortunately, the quality of IA reports is improving and this is increasingly being reflected in the manner of their use in Parliament. These successes should be built on and should also inform a push for improving other instruments, including post-implementation reviews. There is additional scope to strengthen all such assessments by engaging academic researchers – easily the most under-utilised source of evidence on the effectiveness of regulations.

One particularly important role for IAs should be to distinguish between business-as-usual regulatory costs, corresponding to commercial good practice, and true regulatory burdens. Similarly, post hoc assessments should try to separate efficiencies achieved by businesses by streamlining compliance from actual reform-driven savings. Policy-makers have often lazily conflated these concepts, leading to the identification of false burdens and savings that have tested the credibility of the Regulatory Reform agenda.

To support this programme of work, the Government needs to seriously consider its approach to developing better regulators. Learning and innovation in the regulatory apparatus has been focused on the tools and methods associated with the Better Regulation agenda, but much more needs to be done to embed regulatory reform expertise and elevate the status of regulatory reform within the civil service. A thorough assessment of skills needs in regulatory reform could kick-start badly needed changes in this respect.

MANAGING CROSS-SUBSIDIES

Managing regulatory cross-subsidies is, to date, the least understood aspect of regulatory reform and there are no performance measures to ensure appropriate scrutiny – this was part of the rationale behind the now-abandoned proposals for a system of regulatory budgets.

One very important implication of our analysis of regulatory learning and innovation, as well as of the importance of regulatory churn to business perceptions of the business environment, is that intuitive, simple solutions such as the 'one-in, one-out' rule are unlikely to be an improvement on the status quo; more importantly though, they are no substitute for regulatory budgeting because they overlook the critical issue of cross-subsidies.

The Regulatory Budgets project does not need to be resurrected for the time being. Its objectives can still be met to a reasonable extent by building on existing tools and introducing simple metrics to account for cross-subsidies, as well as by strengthening the voice of consumers in consultation. We also note that recent work on understanding and managing public risk has given policy-makers some valuable tools which will now need to be embedded into the machinery of government.

But methodology aside, managing cross-subsidies is a political act, and it is therefore properly the province of politicians rather than civil servants. Although independent bodies and external experts might help to provide clarity in the more complex cases, this agenda should be permanently owned at Cabinet level and subject to the highest possible levels of public scrutiny.

TOWARDS A VALUE-ADDING REGULATORY SERVICES INDUSTRY

The regulatory services industry is a relatively recent concept, but a very useful once nonetheless. It should be widened to encompass the full range of private and public sector providers of regulatory advice, information and guidance, as well as the more traditional areas of enforcement and inspection.

Despite being the most recent addition to the Regulatory Reform structures, the LBRO appears to own the regulatory services agenda to a large extent and has engaged in an impressive amount of research. So far, this work has focused on the public sector arm of the regulatory services industry and produced a practical and potentially useful model for integrated inspection and enforcement.

Government should focus on removing the organisational, cultural and resource barriers to such integrated delivery, and on reconciling this agenda with the largely overlooked part of the Anderson Review recommendations which address building professionalism and advisory capacity in the public sector.

On the other hand, government also needs to acknowledge its limitations in the provision of regulatory advice and focus on those areas, such as enforcement and inspection, where it has a natural advantage. Elsewhere, the resources of the private sector must be further engaged to improve regulatory outcomes.

Foremost among these are the resources of accountants both in practice and in industry, who are the most commonly used regulatory advisers for small and medium-sized enterprises. The range of their regulatory services is surprisingly wide, and is particularly strong in crucial areas such as employment law. It may be particularly useful for government to study the business models of regulatory advice among accountants in order to derive insights into how professional skills can be leveraged to build a regulatory services offering.

The function of the regulatory services industry can influence regulatory outcomes more than the design of regulations themselves. Government therefore needs to obtain a much better understanding of compliance behaviour among small businesses if it is to design and enforce regulation in an optimal manner. This will rely to a great extent on making better use of less aggregated, grass-roots information, including through the Small Firms Consultation Database.

MEASURING PROGRESS IN REGULATION

The Better Regulation agenda has been guided for years by the tenet that what gets measured gets done. This is of course true – but it implies that developing the right measures of success is paramount.

The Government's preferred measures for regulatory reform, derived from impact assessments and based on the Standard Cost methodology, are of course useful as internal management and reporting tools. They are not, however, meaningful numbers in any other sense: they are statistically unreliable, inconsistently captured within and across departments and over-aggregated. Yet even if they were methodologically flawless, they would still only have a heavily mediated relationship with policy-makers' and stakeholders' preferred outcomes, and would still lumber civil servants with perverse incentives. All of this is deeply harmful to the credibility of the Regulatory Reform agenda.

Part of the solution to this problem must be for the Government to draw on independent evidence of real-world outcomes – real influences in the behaviour of businesses and individuals attributable to regulation. Outcome-based measures of regulatory reform are not only more intuitive and appealing to wider range of stakeholders, but also easier to integrate into the policy-making process – from the setting of political objectives to consultation, impact assessment and post-implementation reviews.

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