

## Towards a Red Tape Trading Scheme: Treating Excessive Bureaucracy as Just Another Kind of Pollution

Oliver Marc Hartwich

EXECUTIVE SUMMARY

No. 121 • 19 May 2010

For many years now, trading schemes have been used as mechanisms to reduce environmental pollution. The principal idea behind such schemes is that they allow emissions to be cut where it is least costly.

A similar idea could be applied in the area of better regulation. Although in some areas regulation may be desirable or necessary, there are regulatory costs associated with it. The challenge for politicians and regulators is to keep these costs to a minimum. A trading scheme for regulatory costs could help achieve this.

The basic idea behind such a trading scheme is borrowed from trading schemes for environmental pollutions. After an initial stock-take of regulatory costs (the bureaucracy costs resulting from regulation), certificates are issued to government departments and agencies. These certificates give them the right to impose regulatory costs on business. In the next step, the total amount of certificates is cut below the initial level. Government departments will then have to cut the regulatory costs they impose; if they fail to achieve these cuts, they have to purchase certificates from other departments.

Such a trading scheme for regulatory costs would ensure that regulatory costs are removed where their removal is easiest. Regulators would be free to creatively simplify regulations and reduce their burden on society.

In order to make a regulatory cost trading scheme work, a precise measurement of existing regulatory costs is necessary. Even without a trading scheme, it would still be desirable to measure these costs because we can only speculate the current costs of red tape to the Australian economy.

In recent years, the Dutch have pioneered a system to measure regulatory burdens. The Standard Cost Model, which was pioneered by the Dutch ACTAL authority, measures regulatory burdens. It identifies the amount of time necessary to comply with a specific regulation and then calculates how much this would cost. This figure is then multiplied by the number of businesses affected by the regulation, which delivers the total regulatory burden associated with this particular measure.

By measuring red tape through the Standard Cost Model, the Dutch have been able to issue targets for reducing these burdens. The Dutch model has been so successful that other countries have adopted it.

This report argues that the Dutch approach is a good first step in dealing with regulatory burdens, and if it is applied in combination with a trading scheme for regulatory burdens it could unleash even greater creativity in identifying ways to cut red tape where it is least needed.

**Dr Oliver Marc Hartwich** is a Research Fellow at The Centre for Independent Studies. The author thanks his colleagues at the CIS for their comments on an earlier draft of this paper. Responsibility for any errors remains the author's.



## Introduction

During the days of political frenzy when the government's emissions trading scheme (ETS) was debated in Parliament in December 2009, The Centre for Independent Studies hosted a lunch with Gary Banks AO, chairman of the Productivity Commission. In his speech, Mr Banks spoke about the wide range of issues of interest to him and the Productivity Commission, one of which was the problem of reducing bureaucracy. Although governments all over the world have been experimenting with various forms of 'better regulation' regimes (as if anyone had ever called for worse regulation!), it seems as if very little had been achieved in turning the tide on regulation and actually reducing red tape. Mr Banks, who has served as chairman of the Regulation Taskforce, certainly knew what he was talking about.

Limiting regulatory costs, cutting red tape, and reducing regulatory burdens are standard ingredients of political rhetoric. What makes them so attractive to politicians in speeches and electoral manifestoes is the fact that no one can argue against them. Across the political spectrum, everybody agrees in principle that unnecessary burdens on businesses and households have to be avoided. They may disagree on the areas that need to be regulated but concur that regulations, once mandated, must be enforced in the most efficient way.

There is no merit in filling out 50 forms when 40 could do the job just as well. Making the regulatory process more difficult than it ought to be is a waste of resources for both the regulated and the regulators. Not only do the redundant forms have to be redesigned, printed and filled but someone in a government department has to deal with them—even if it only means filing them.

The logic behind reducing red tape is compelling. In theory, it is in nobody's interest to have excessive form-filling and compliance requirements, and we would all be better off reducing bureaucratic burdens. In practice, though, it has proven extremely difficult to get rid of such regulatory pollution.

'What pollution?' readers may ask. Regulatory burdens are not some kind of waste, used oil, or industrial noise? However, there are good reasons to believe that regulatory burdens have a lot in common with conventional pollution.

According to the *American Heritage Dictionary of the English Language*, a pollutant is something 'that pollutes, especially a waste material that contaminates air, soil, or water.' So pollution is a wasteful and undesirable by-product of a process. How better to describe regulatory burdens?

At the time Mr Banks was emphasising the need to reduce bureaucracy, Australian politicians were debating the introduction of an emissions trading scheme for greenhouse gases. Although the two issues are not directly related (despite the high implementation costs of the complicated emissions trading scheme), together they formed the idea behind this paper (for which Mr Banks, of course, should not be held responsible): If regulatory burdens can be considered as pollutants, and if an emissions trading scheme is in principle an interesting way of dealing with pollution, could we design an emissions trading scheme for regulatory costs?

This paper argues, only a little tongue-in-cheek but otherwise entirely seriously, that a Red Tape Trading Scheme could indeed be an option worth exploring. Trading schemes for pollutants are obviously not a new idea, but no one has yet attempted to apply them to red tape. Maybe it is time to give it a try.

## Basics of regulatory trading explained

The idea of combining pollution trading with regulatory burden reduction may still be a bit hard to visualise but need not be so. It is the same kind of mechanism used for trading environmental pollutants. Only the players are different.

Ordinary trading schemes usually deal with emitters of environmental pollutants. Typically, these are private companies: utilities, manufacturers, airlines, and so on. They are in the business of producing a variety of goods and services but, in doing so, they also emit purportedly undesirable substances such as carbon emissions.

**It is in nobody's interest to have excessive form-filling and compliance requirements, and we would all be better off reducing bureaucratic burdens.**

An environmental trading scheme is designed to drive down the total emissions by all players in the market, which is why the amount of emissions gets capped below current total emissions. However, a trading scheme lets market participants decide by how much each individual participant cuts emissions. Each player purchases emissions certificates from the market on which these certificates are traded so that players with the lowest pollution reduction costs cut their emissions first.

To transpose such an environmental trading scheme to regulation, we need to identify the players. Clearly, all concerned regulatory burdens ultimately derive from government, a monopolist for regulatory pollution.

However, this is only true in the aggregate of all government agents. For the purpose of the Red Tape Trading Scheme, the government is treated as a number of competing players, i.e. government departments (broadly defined). Instead of treating government as a single entity imposing regulatory pollution on people and businesses, each government department is treated as an individual polluter.

Splitting government into its components is, of course, nothing unusual. It happens in every budget, where government gets treated as a number of separate entities competing for their respective share of the budget. This is precisely how government will be treated in this paper for the purpose of designing the Red Tape Trading Scheme.

In the fiscal budgetary process, all government departments are allocated funds to use towards their departmental spending plans. Under a Red Tape Trading Scheme, the total regulatory burden of government could be determined by measuring each department's regulatory pollution. Government would then set itself a target, say a 5% reduction in the total regulatory burden in one year. To achieve this target, government would cap the total sum of regulatory burdens at, say, 95% of the baseline year.

What happens next is precisely the kind of cap-and-trade mechanism that exists under emissions trading schemes. All government departments would receive Red Tape Certificates worth 95% of their current regulatory pollution. The minister heading a department would only be allowed to cause regulatory burdens 5% below the current level. However, there would both be an incentive to go beyond the 5% reduction target and a punishment for not meeting it. Both the incentive and the punishment would be delivered through the Red Tape Trading Scheme.

Just like in an emissions trading system, there would be a marketplace where pollution certificates can be traded. The only difference would be that the trade would not happen between private companies but between government departments. If a government department is able to reduce its regulatory burdens by more than the target it will have spare certificates, which it no longer needs. These excess certificates can be sold to departments that have been less successful at reducing their red tape. Only allocated funds can be used to purchase certificates from other departments, so that ministers and bureaucrats feel their failure in cutting back regulatory burdens in their pockets. Similarly, a government department that excelled at cutting back burdens would be rewarded with extra funds, which it could spend as it wished.

Just as in a carbon trading scheme, it would be left to the participants to decide how and where to cut their emissions. All they would be told is their allocation of emissions certificates, which basically constitutes a target. But the decisions over individual pollution reduction measures have to be made on the ground. This is advantageous because the knowledge about reduction potentials is usually better the closer you get to the source of the pollution. It is the practitioners who would know best what potential there is for emissions reductions. In this case, bureaucrats are possibly most aware of the burdens they place on households and businesses. So they are best placed to estimate how necessary these burdens really are.

The general advantage of any trading scheme is that it uses dispersed knowledge about pollution reduction potentials. All that the organisers of the scheme have to decide is the total allocation of emissions certificates. Beyond that, it is no longer up to them to identify specific measures but only to make sure that the trading mechanism works.

**Bureaucrats are possibly most aware of the burdens they place on households and businesses.**

Summing up, the basic idea of a Red Tape Trading Scheme borrows much from similar schemes used to drive down environmental pollutions. It uses precisely the same mechanism of capping the total amount of emissions (here, regulatory burdens) across the market (here, across all government), but then leaves it to individual participants in the scheme (here, government departments) to decide the ways in which to cut their individual emissions. And it also makes the permits to pollute tradable in a market, thus rewarding the most efficient players and punishing the least successful.

The idea is quite simple but the devil may well be in the detail. Who is going to measure and monitor regulatory pollution? Who would be in charge of running the trading scheme? How would the scheme's operation influence the running of government services? The following sections will address these questions.

## Going Dutch about measuring red tape

Every emissions trading scheme has to begin with measuring the current level of emissions. Only after the total emissions have been determined is it possible to decide how many pollution certificates to issue.

Getting this initial measurement right is essential for the operability of an emissions trading scheme. If the measurement is too generous, prices for permissions to pollute can drop to zero. This is what happened to the European carbon emissions trading scheme after too many certificates were issued. On the other hand, if measured too low then future reductions targets may be too ambitious and, eventually, unattainable.

Measuring regulatory burdens is difficult, as anyone who has dealt with them can confirm. When Gary Banks gave the inaugural lecture to the Monash Centre for Regulatory Studies, he could only present rough estimates ranging from tens of billions of dollars to a more precise figure of \$86 billion that the Australian Chamber of Commerce and Industry had estimated in 2006, but for which he had concerns about the way it was calculated.<sup>1</sup>

The way the Commonwealth government deals with deregulation, it seems it is not attempting to actually measure the costs of regulation at all. Instead, it is focusing its efforts on the individual areas of regulation in which it aims to reduce regulatory costs. Fair enough, but such a practice would not be sufficient for a Red Tape Trading Scheme. Without a proper measurement of regulatory costs, a government committed to cutting regulatory burdens by a certain amount would never quite know what it has achieved and how much more it has to do on this agenda.

This is why, regardless of whether you want to introduce a trading scheme, it would be highly desirable to introduce a systematic evaluation of all red tape related costs. As mentioned earlier, only estimates are available, and these are done outside of government, their methodologies differ from each other and, consequently, their sums differ as well. It would certainly be preferable if there was one official stock-take of regulatory costs that the government would accept as the basis of evaluating its cost cutting measures.

In recent years, the Dutch have pioneered an approach to measure regulatory burdens, the so-called Standard Cost Model. Developed in the Netherlands, it has been so successful in identifying and measuring regulatory burdens that a large number of countries have adopted it. Victoria joined the international Standard Cost Model initiative in 2007.

The basic approach behind the Standard Cost Model is easily explained.<sup>2</sup> It is not concerned with the goals of regulations but only with their administrative costs, which it aims to measure. Whether a regulation itself is needed or makes sense is not the concern of the Standard Cost Model. It takes all regulations as a given and focuses only on the compliance costs.

**Without a proper measurement of regulatory costs, a government committed to cutting regulatory burdens by a certain amount would never quite know what it has achieved.**

The Standard Cost Model uses a basic formula to measure administrative costs for the private sector:

Price x Time x Quantity

Price = hourly wage plus administrative overheads that those affected by a regulation are paid

Time = time required to deal with a regulation

Quantity = the number of units that have to comply with the regulation and the frequency in which they have to deal with it

For example, if 100,000 businesses have to fill a form twice a year, filling it takes half an hour, and the employees who fill this form cost \$50 an hour, then the total administrative cost of this regulation is  $100,000 \times 2 \times 0.5 \times \$50 = \$5,000,000$ .

In practice, such calculations can and will be much more detailed. Forms are often not handled by just one employee but by a range of different employees with different costs associated. The task of filling a simple form concerned with an information obligation can be split into numerous subtasks, as this example from the German government's manual on the Standard Cost Model illustrates:

**Table 1:** German example of analysing information costs<sup>3</sup>

No.	General standard activity	Standard time (minutes)	Wage costs (€)
1	Familiarisation with the information obligation	10	33
2	Receiving the information	2	28
3	Collecting the required information	19	28
4	Assessing the required information and data	6	33
5	Filling in or entering the required data	5	28
6	Making calculations and/or estimates	5	61
7	Printing out/recording the results	3	33

This may look complicated but is quite straightforward. It does not need to measure the costs in every single individual business; rather, it attempts to estimate an overall figure for each regulatory measure. In this way, the commission that was set up to deal with regulatory burdens in the Netherlands did a stock-take of all Dutch regulatory costs.

In the Netherlands, the *adviescollege toetsing administratieve lasten* (ACTAL) (advisory council for administrative burdens) was founded to estimate the total administrative costs for the whole country and then monitor the progress made in reducing them. Perhaps even more importantly, ACTAL was given the task of estimating the additional regulatory burdens of proposed regulations.

The first measurement of administrative burdens, completed in 2002, was estimated to be worth €16.2 billion. The government then issued a reduction target of 25% over five years, which was achieved by the end of 2007. Another 25% target has been set for 2011. The World Bank declared the Dutch approach towards reducing red tape was the best in the world.<sup>4</sup>

Perhaps the most important factor in the Dutch success is its simplicity and narrow focus. It does not attempt to deliver a full cost/benefit analysis of regulation. It does not ask whether a regulation is politically desirable. It does not deal with taxes or fees. It does not aim to quantify the physical costs of implementing new regulations, for example, when new environmental standards require the installation of new equipment. The only focus of the Dutch model is the bureaucracy that new regulation creates—the form filling, the provision of statistics to government departments, the time it takes to apply for permissions and licences.

**Perhaps the most important factor in the Dutch success is its simplicity and narrow focus.**

In their approach, the Dutch have thus focused exclusively on what could reasonably be labelled a wasteful by-product of regulation. Their goal is to drive down regulatory pollution without questioning the regulation. It is not for ACTAL to give an opinion on the contents of new laws but only whether the goals of these laws could be achieved in a simpler, less costly way.

### **Measuring red tape needs an independent home**

Despite the task of effectively overseeing the red tape effects of all new legislation and advising on reducing regulatory burdens of existing laws, ACTAL has remained a small organisation. Three board members are assisted by a staff of just 13 people. On its website, ACTAL describes its own role as:

ACTAL, the Dutch Advisory Board on Administrative Burden, is a temporary, independent advisory board whose aim is to bring about a cultural shift among legislators and regulators. Their duty is to reduce the regulatory pressure on businesses, citizens, institutions, professionals, and local authorities automatically and permanently. Actal acts as a watchdog and facilitator, strongly backing the Dutch government's objective to bring about a 25% net reduction in the overall administrative burden by 2011.

To promote this cultural shift, ACTAL advises the government and Parliament on the impact of regulatory pressure of planned laws and regulations, and on programmes that aim to reduce existing regulatory pressure. For example, Actal supports lawmakers and local authorities by carrying out projects that contribute to the mitigation of regulatory pressure.

Actal is an organisation that is placed outside of political decision-making, focusing solely on advising government departments and Parliament on the reduction of regulatory pressure. Actal does not address the political goal of any legislative proposal. It aims to make the impact of certain political choices transparent and it suggests ways in which this goal can be achieved more effectively and with less regulatory burden.

ACTAL's independent nature has clearly contributed to its success. ACTAL's advice counts and cannot be dismissed out of hand. This is remarkable because ACTAL was set up as a temporary body and is still, a decade later, a relatively young organisation.

Australia also has a strong culture of independent bodies, such as the Australian Competition and Consumer Commission, the Reserve Bank of Australia, and the Productivity Commission. Of these, it is probably fair to say that in its outlook and focus on economic efficiency, the Productivity Commission comes closest to the goals of the Dutch ACTAL. In fact, as was pointed out earlier, it was no coincidence that Gary Banks, as chairman of the Productivity Commission, was also once head of the Regulation Taskforce.

Given this background, a concerted effort to implement Dutch style regulatory reforms in Australia should have its institutional home at the Productivity Commission. The Commonwealth government's Office of Best Practice Regulation (OBPR) would be another contender for the task of driving the new system. However, the OBPR is too much part of the government and would lack the independence that ACTAL—and the Productivity Commission—enjoy. It would be better to locate the Red Tape Trading Scheme with the Productivity Commission.

The Productivity Commission's mandate should be extended to include measuring administrative burdens through the Standard Cost Model and monitoring these burdens over time. This would also mean that just like the Dutch ACTAL, the Productivity Commission would routinely be consulted on any new piece of legislation and regulation with regard to its effect on administrative costs.

**The Productivity Commission's mandate should be extended to include measuring administrative burdens through the Standard Cost Model and monitoring these burdens over time.**

The Productivity Commission's role within a Red Tape Trading Scheme could, however, go beyond that of ACTAL. The core part of any pollution trading scheme is the market on which such trading takes place. The Productivity Commission should be the key facilitator because it has the necessary information about the current level of regulatory burdens since it has originally measured it through the Standard Cost Model. It also knows how much additional regulations will cost in terms of their administrative burdens and how much costs reductions have been achieved through better regulations. So if the Productivity Commission already has all the information about the state of regulatory pollution, it would be logical to put it in charge of organising the market for Red Tape Certificates between government departments.

Under the Red Tape Trading Scheme, the Productivity Commission would thus be in the driving seat of regulatory reform without actually determining where precisely to cut regulatory costs. This would still be left to the government departments, which should in any case know much better than any outside agency where there is potential for driving down costs. However, the Productivity Commission would be able to assist in this process through providing independent cost estimates and organising the process of certificate trades between departments.

Overall oversight and responsibility for reducing red tape would be with the Productivity Commission, while the individual cost reduction measures would be controlled by individual government departments. The overall reduction target would be set by the government.

### **How would Red Tape Trading work in practice?**

As far as we know, no one has tried to achieve regulatory reform through an ETS-like system. Nevertheless, it should not be too difficult to imagine how it would work.

In the first phase of the Red Tape Trading Scheme, the Productivity Commission would be given additional powers for establishing a comprehensive monitoring system for regulatory burdens based on the Standard Cost Model. Its first task would be to measure the existing regulatory burdens for each government department and agency. In the Netherlands, this was also the first task that ACTAL had to fulfil. This initial stocktaking should not take longer than two years, which was the time it took from the founding of ACTAL until the Dutch government issued its first 25% reduction target.

Following the setting up of a Standard Cost Model, information would be available about the state of administrative burdens in Australia. The government would use this information as its baseline—just as a baseline pollution was defined under the Kyoto Protocol for carbon emissions. It would then be for the government to set a target for an overall regulatory emissions reduction.

As in any emissions trading scheme, there is always a danger that the polluters will attempt to gain special concessions. The debate over the government's Carbon Pollution Reduction Scheme has provided ample evidence for this. Such bargaining should be avoided when it comes to the Red Tape Trading Scheme. Instead, the government should only issue one reduction target as a percentage and apply it across the board. Each regulatory polluter should be given the same target.

In the Netherlands, an initial five-year period was chosen to deliver the first 25% cut in regulatory burdens. However, there is no reason why more moderate targets should not be set for shorter periods of time. In fact, it may be advantageous to use shorter periods such as the fiscal year and synchronise the fiscal budget process with the Red Tape Trading Scheme. With each fiscal year, regulatory polluters would also receive an annual regulatory burdens budget, i.e. certificates for administrative burdens.

So in the first year of Red Tape Trading, the government could mandate a 5% reduction for all government departments. Red Tape Certificates worth 95% of the base year's regulatory pollution would be issued to all regulatory polluters. This means that

**All government departments and agencies would have to find ways to drive down their administrative burdens.**

all government departments and agencies would have to find ways to drive down their administrative burdens or buy Red Tape Certificates from departments that had been more successful at reducing red tape in their areas.

Bureaucrats from department X may find an ingenious way of cutting red tape by 7%, while their colleagues in the equally pollution intensive department Y may only find 3% reductions. In such a case, Y would be able to buy the extra Red Tape Certificates from X on the market organised by the Productivity Commission. A government department that is good at reducing its administrative burden on business and society would thus be rewarded with a higher budget while departments with worse regulatory results would be punished.

To achieve the strongest possible incentive for increasing the efforts to drive down regulatory costs, departments should be free to decide how to spend the additional revenue from Red Tape Trading. Bureaucrats who manage to reduce red tape in their departments could be paid a bonus but, in general, the head of the department should decide how to spend the funds.

### **Red Tape Trading and the Standard Cost Model: the future of regulatory reform?**

The suggestion to treat administrative burdens as a kind of pollution and treat it like any other kind of pollution is meant to be tongue-in-cheek. But not entirely.

It is true that administrative burdens, sulphur emissions, and greenhouse gases probably require different policy responses. Nevertheless, they do share characteristics that can be interpreted as wasteful by-products of something else, which makes it possible to treat them as pollutions.

In environmental policy, there have long been debates about the best ways of reducing pollution. Theoretically, one of the best approaches is emissions trading because it makes it possible to cut pollution where it can be achieved at the least cost. However, the difficulties in establishing such trading schemes are all too well known, such as the tendency to compensate polluters.

When it comes to regulatory pollution, this pitfall of a trading scheme could be avoided relatively easily if the government committed itself to an across-the-board cut. It would be hard to argue against such a measure. How would government ministers explain the need for their departments to continue burdening business and society with more red tape than their colleagues? In practice, it would be politically embarrassing for politicians to impose greater bureaucratic burdens on society.

The key to a successful process of reducing administrative burdens are simplicity and independent monitoring, as demonstrated by the Dutch example. It was the straightforward nature of the Standard Cost Model that made it easily applicable across departments. And it was the independence of the ACTAL commission that gave their measurements and advice political weight. Australia should learn from these lessons. This does not mean that ACTAL should be copied, but Australia certainly has a highly respected body in the form of the Productivity Commission, which could fulfil the part of a facilitator of regulatory reform as well.

Even if Australia only had an official estimate of total regulatory burdens, it would be a sign of progress. It would be even better if Australia managed to reduce them by a fraction each year—monitored and verified by an independent body. And if Australia designed a scheme informed by experiences in other areas of pollution reduction, it could become a promising new approach for regulatory reform.

An emissions trading scheme for bureaucracy is indeed not meant to be taken entirely seriously. Nor is it a scheme that has been tried and tested anywhere else. It is merely an idea. But perhaps it is a good one.

**The suggestion to treat administrative burdens as a kind of pollution and treat it like any other kind of pollution is meant to be tongue-in-cheek. But not entirely.**

## Endnotes

- 1 Gary Banks, 'Reducing the regulatory burden: the way forward,' Inaugural Public Lecture (Monash Centre for Regulatory Studies, University Law Chambers, Melbourne, 17 May 2006).
- 2 For more detailed information see, for example, the *International Standard Cost Model Manual*.
- 3 German Federal Statistical Office, *Introduction of the Standard Cost Model—Methodology Manual of the Federal Government*.
- 4 Simeon Djankov and Peter Ladegaard, *Review of the Dutch Administrative Simplification Programme*, World Bank Group Research Note.





**Issue Analysis** (ISSN:1440 6306) is a regular series published by The Centre for Independent Studies, evaluating public issues and Government policies and offering proposals for reform. Views expressed are those of the authors and do not necessarily reflect the views of the Centre's staff, advisors, directors or officers. Issue Analysis papers (including back issues) can be purchased from CIS or can be downloaded free from [www.cis.org.au](http://www.cis.org.au).