

8 May 2014

Regulatory Institutions & Practices Inquiry
New Zealand Productivity Commission
PO Box 8036
The Terrace
Wellington 6143

Email to: info@productivity.govt.nz

Dear Sir/Madam

Re: Regulatory Institutions & Practices – Draft Report

1. Background

I am writing to you regarding the New Zealand Productivity Commission's (NZPC) draft report entitled *Regulatory Institutions and Practices* (referred to as 'the Report').

BusinessNZ previously took the opportunity to submit on the Inquiry's Issues Paper, outlining both our overarching thoughts and observations about regulatory practices in New Zealand, as well as giving recent examples of both positive and negative regulatory practices.

2. General View of the Report

Overall, we believe the NZPC has done a very good job of comprehensively addressing the issues that may affect regulator capability and behaviour. While the length of a report should never be the sole determinant of its quality, the fact that the Report covers in detail 12 substantive issues relating to regulatory institutions and practices in this country means the main design features of the terms of reference have been more or less covered.

BusinessNZ supports the majority of findings and recommendations outlined in the Report and in addition, would like to make some general observations, as well as one specific point on a matter the Report raises.

3. General Observations

The role of the Regulatory Responsibility Taskforce

In our first submission on the inquiry, we took the opportunity to outline the timeline of events involved in the examination of a Regulatory Responsibility/Standards Bill. This included extensive work by the Regulatory Responsibility Taskforce, which in September 2009 produced a 69-page report.

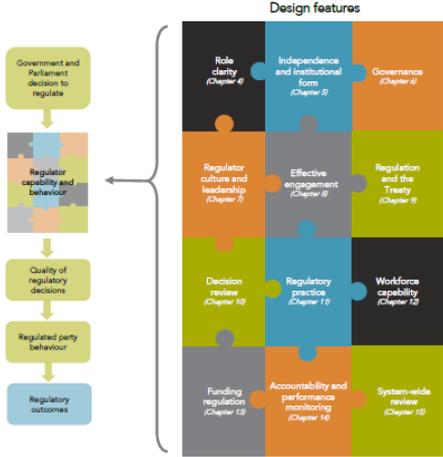
While the NZPC’s Report includes the 2012 Treasury paper that examined a revised Regulatory Standards Bill, BusinessNZ is surprised that in a 460-plus page report there is absolutely no mention of the work of the Taskforce, or indeed of any of the papers, points or discussion that came from that inquiry. While we accept that the terms of reference for the current inquiry mean that topics that involve improving the policy-making process for developing new regulation or regulators do not always align with what the Taskforce examined, elements of its work are relevant to determining how New Zealand can improve its regulatory institutions and practices.

Recommendation: *That the Commission acknowledges and includes where useful the work of the Regulatory Responsibility Commission in the final report.*

Compliance costs – the shockwave of regulation

The Report identifies 12 design features that need to be examined to enhance New Zealand’s regulatory system, replicated in figure 1 below.

Figure 1: Design features of Regulator Capability and Behaviour



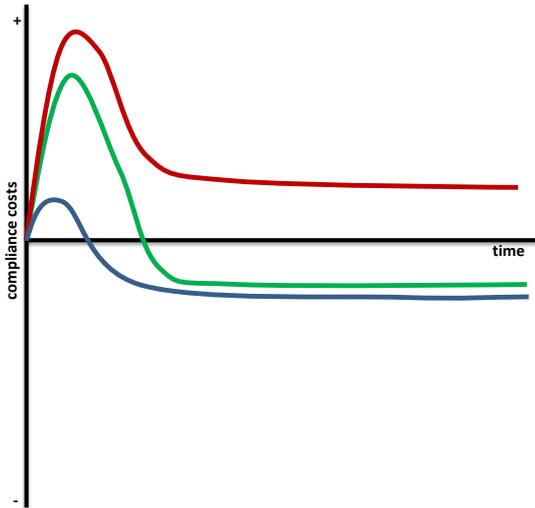
In relation to the importance of the inquiry, page 1 of the Report states that ‘poorly conceived and implemented regulatory arrangements can also impose significant costs. Such costs affect business productivity and profitability, and the wealth of individuals and families. Ultimately this will harm the country’s economic

performance and wellbeing'. Often top of mind for many businesses are compliance costs, which are at best loosely mentioned throughout the Report.

One direct way in which the success or otherwise of regulation can be calculated involves measuring business compliance costs. While compliance costs are one part of the total cost of regulation, it is the one that provides a basis on which to gauge whether regulations comply with many requirements such as ease of understanding, usefulness etc. In crude terms, compliance costs are an outcome of regulation.

However, attempts to measure these types of costs within New Zealand over time have been haphazard at best. There has been little research to show exactly how these costs change over time. To better monitor compliance cost trends, Figure 2 shows a phenomenon that was clearly evident in the time series data of two compliance areas for the BusinessNZ KPMG Compliance Cost Survey, which ran annually from 2004 to 2008.

Figure 2: Shockwave of Regulation



During the time the survey was conducted, changes in the Holidays Act and Employer Related Superannuation Scheme (via KiwiSaver) led to a direct cause and effect between changes to legislation and the resulting compliance burden, both in terms of compliance cost trends and compliance cost priorities.

Any legislative or regulatory change involves a cost, no matter how well it is implemented. Time taken to understand new processes, additional resources required or time taken from other activities are all costs that more often than not cannot be avoided. The Compliance Cost Survey found that the two effects measured resembled the red line in figure 2, which is an example of what we typically refer to as the 'shockwave' of regulation. While we would expect an increase in compliance costs because of changes to legislation or regulations, regulatory changes that are of lower quality create an initial substantive shockwave in the immediate years after the changes were made, and in some instances there is no recovery back to the level before the changes were introduced. What the red line

showed with the Holidays Act changes was that changes meant to improve regulatory settings ended up permanently increasing costs.

Instead, a more successful regulatory change would be a green line that shows a similar increase in compliance costs, followed by a trend line that shows an overall lower level of compliance costs. The best outcome, which is often difficult to achieve, is the blue line where the initial costs of change are low and an overall net benefit quickly results.

Therefore, while we broadly agree with how the regulatory institutions and practices can be broken out into the 12 design features contained in the report, collectively the right path for these features is to ensure that enhanced regulatory practices largely lead to a reduction in business compliance costs.

Recommendation: That the Commission acknowledges the importance of reducing compliance costs for business in their report.

4. Specific Comments

As stated above, we believe the NZPC has done a good job in outlining the issues relating to the 12 design features of regulatory institutions and practices. However, there is one specific area that we would like to comment on.

Giving actions like Really Responsive Regulation the best head start

We agree with the Report's view that '*regulating is a deeply challenging task*' (page 11), and that ensuring effective implementation and administration of a regulatory regime is a central concern. In fact, we view the issue of regulatory practice as one, if not the, key piece when compiling the regulatory puzzle for this inquiry.

The Report outlines 43 recommendations for the government to consider. A question to consider is if all recommendations were to proceed, would this enhance the quality of regulatory institutions and practices to such a degree that there would be a significant improvement in the design of new regulatory regimes and system-wide improvements in the operation of existing regulatory regimes in New Zealand? While we believe the recommendations outlined are generally in the right direction, the current inquiry only looks to enhance the box of regulator capability and behaviour seen in figure 1. The ability to achieve significant change also requires an examination of the other boxes that make up the process by which regulation occurs.

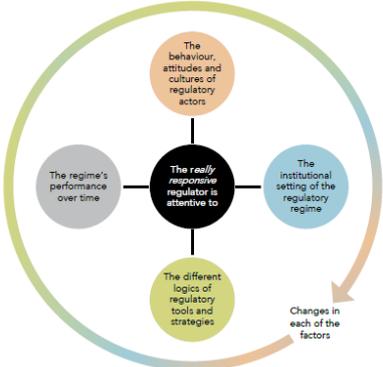
To illustrate this point, one example is the discussion that has come out of the concept of Really Responsive Regulation (RRR), mentioned in chapter 11.

We agree with the statement on page 262 of chapter 11 that "*adopting a risk-based regulatory approach presents significant issues for the regulator that challenges the notion that it provides "an evidence-based means of targeting resources" or a defensible framework for undertaking enforcement activity.*" We also agree that while the standard approaches around responsive regulation are a good base to start from,

the concept of RRR needs to be seriously considered. While some New Zealand regulators are demonstrating elements of the really responsive approach, the evidence suggests that New Zealand regulators are not paying enough attention to how their regimes perform over time.

Figure 3 below replicates the figure in the Report that outlines what a regulator must be aware of and responsive to when adhering to the concept of a RRR.

Figure 3: The Really Responsive Regulator



Question 11.1 of the Report asks whether recent developments in the theoretical literature described in the Report have application in the New Zealand context, both for the design of new regulatory regimes and their implementation. BusinessNZ believes they do, given that in most instances a sophisticated institutional approach will be preferable to the more static approach currently taken today.

However, while the move towards RRR is one we support, we believe that its success or otherwise will also depend on how the decision to regulate is handled in the future.

In relation to this, BusinessNZ attended a presentation that focussed on RRR by Professor Julia Black from the U.K, when she was in this country in March. What struck BusinessNZ staff after hearing the subsequent statements and questions from New Zealand regulators, was how the political aspect of regulation significantly hangs over current regulatory processes.

The general view from both the regulators and from Professor Black’s response was that this aspect is now widely acknowledged as one that can and does create significant difficulties for regulators, and there currently appears to be little that can be done to improve this situation. What is required is a specific approach that would apply to the first box in the figure 1 above, namely the *‘Government and Parliament’s decision to regulate’*. Without changes that go beyond the terms and references that this inquiry is focussed on, recommendations such as introducing RRR may fall short of their potential to improve regulatory practices in New Zealand.

As we outlined in our first submission on the inquiry, and have alluded to above, an inquiry on regulatory practices that does not also take into account the Government’s

initial decision to regulate will mean the end result not having the desired level of effect intended. To that end, we remain committed to the fact that some form of Regulatory Responsibility Act is required in New Zealand to ensure that the political aspects of regulation making do not become an undue burden on regulators and the policy making process.

Recommendation: That the Commission acknowledges the importance of addressing the earlier stages of the regulatory process to ensure the quality of regulation is improved.

Thank you for the opportunity to comment, and we look forward to further discussions.

Kind regards,

A handwritten signature in black ink, appearing to be 'P. O'Reilly', with a long horizontal stroke extending to the right.

Phil O'Reilly
Chief Executive
BusinessNZ