SUBMISSION TO THE ERA BUSINESS LICENCING REFORM INQUIRY

CHAMBER OF COMMERCE AND INDUSTRY WA

APRIL 2018

Summary of Recommendations

1. To improve the efficiency of business licencing schemes, the *Analytical framework and guideline* should assist government agencies in identifying how market structure would impact a new licence, and how the new licence would impact market structure.

2. Government agencies should evaluate the marginal benefit and marginal cost of any proposed new licencing scheme, rather than the scheme's benefits and costs in isolation of other regulation.

3. Government agencies should consider combining licences for complementary business activities where it doesn't increase entry costs to the market.

4. Government agencies should consider licencing requirements for the same business activity in other jurisdictions and evaluate the extent to which market participants transact across multiple jurisdictions.

5. The government should develop policies to encourage data-sharing between government agencies (and interstate) to support a holistic approach to designing regulation.

6. A timeline for a review of new licenses should be established to ensure that they remain relevant

About this submission

The Chamber of Commerce and Industry of Western Australia (CCI) welcomes the opportunity to provide a submission to the Business Licencing Reform Inquiry conducted by the Economic Regulatory Authority (ERA). The focus of this submission is responding to *Consultation Paper 2: Analytical framework and guideline*.

CCI recognises the need to develop a new analytical framework and guideline to assist government agencies in designing, implementing and reviewing their business licencing schemes. As discussed in the consultation paper, the new analytical framework and guideline needs to be easy to use for policy practitioners and should complement existing tools wherever possible. The recommendations in this submission are made with respect to these requirements.

Specifically, this submission builds upon the concepts in the consultation paper and puts forward other concepts for consideration by the ERA in the next phase of the inquiry.

Design and implementation

Business licencing is just one form of government intervention. As discussed in section 2.1.1 of the consultation paper, business licencing can be used to address a range of market failures. For example, business licencing schemes can be implemented successfully to address markets operating with information asymmetry and negative externalities. The objective of market intervention in these cases is to improve the functioning of markets.

Business licencing can potentially improve market outcomes for suppliers as well as buyers. For example, safety can be an important factor in buyers' purchasing decisions. However, in the absence of regulation, it can be difficult for buyers to differentiate between products that meet their safety expectations and those products that do not. Likewise, it could be difficult for any one supplier to convince buyers that their product is safe. Business licencing can help suppliers send a credible signal to buyers that their product has been independently certified as safe to use.

While establishing the need for government intervention is important, the design and implementation of a business licencing scheme is a key determinant of its success. Even if a market failure is correctly identified, government intervention in and of itself does not guarantee better market outcomes. Business licencing schemes should target a specific market outcome. Poorly designed and implemented regulation can produce worse market outcomes. In this way, business licencing is not a 'set and forget' policy instrument and settings should be reviewed periodically.

While existing tools for evaluating business licencing schemes focus on establishing the rationale for government intervention, there is less guidance available on how to design intervention that achieves its objectives.

Market structure

A measured approach to designing a business licencing scheme should incorporate analysis of market structure. Market structure describes the nature of competition in a market and how it functions to distribute wealth. Market structure can be characterised by the number of firms in the market, the number of buyers, the type of competition (competing on capacity or price), the degree of product differentiation/substitutability, market concentration and market power. While there are clear consistent principles for new regulation that can be applied in the case of monopoly, the optimal regulatory settings in oligopoly markets are more complex and often depend on the nature of the particular industry.

The same government intervention can have different outcomes depending on the market structure. For example, the rate of compliance with regulation can be higher in markets where there are a greater number of firms, since the advantage gained from non-compliance over other firms is relatively small compared to the penalty if caught. Therefore, understanding the strategic interactions of firms is critical for designing regulation that achieves its objectives.

Government intervention can also change the market structure itself. For example, the consultation paper discusses the potential for business licencing to create barriers to entry. In addition, the costs of compliance with regulation can be absorbed more easily by larger firms than smaller firms, leading to greater market concentration. These changes to market structure can be at odds with other policy objectives, such as competition policy. Therefore, understanding how a new business licencing scheme will affect market structure is also important in designing effective regulation.

Recommendation

- To improve the efficiency of business licencing schemes, the *Analytical framework and guideline* should assist government agencies in identifying how market structure would impact a new licence, and how the new licence would impact market structure.

The cumulative burden of regulation

The ‘Tinbergen Rule’ in public economics suggests that a policymaker needs one policy instrument for every policy target. Conceptually, each policy instrument or lever will work towards some policy targets and work against others. The inherent trade-offs between different policy decisions means that a different policy instrument is needed for each objective.

This principle underpins the monetary policy approach of many central banks. The Reserve Bank of Australia operates with just one policy instrument (the cash rate) to target three different objectives, and must balance the error in missing one objective against the others. In contrast, government agencies seem to design and implement a new business licencing scheme for every market failure that needs to be addressed. For this reason, an individual business may be subject to multiple business licencing schemes implemented by different government agencies.

In practice, greater co-ordination across government agencies could help in reducing the cumulative burden of regulation. It is possible that some business licencing schemes could also work towards the objectives of other business licencing schemes. In such cases, the two schemes could be combined into a single licence without increasing the costs of entry to the market. The database of business licences produced by the ERA as part of this inquiry serves as a useful starting point to investigate opportunities for merging complementary schemes.

The consultation paper illustrates the cumulative burden of regulation with a simple example where two different safety regulations both achieve a portion of the same outcome. The number of lives saved by both safety regulations is less than the sum of lives saved by each safety regulation considered in isolation of the other. This demonstrates that the appropriate evaluation mechanism for a new business licencing scheme ought not to be whether its benefits outweigh its costs, but whether the marginal benefit outweighs the marginal cost.

The cumulative burden of regulation does not only occur as a result of different State Government agencies, but also across different state government jurisdictions. National reform to standardise state government regulation wherever possible has productivity benefits. For example, in the freight transport industry, different fees, permits and licences apply across each State border.

Recommendations

- Government agencies should evaluate the marginal benefit and marginal cost of any proposed new licencing scheme, rather than the scheme's benefits and costs in isolation of other regulation.
- Government agencies should consider combining licences for complementary business activities where it doesn't increase entry costs to the market.
- Government agencies should consider licencing requirements for the same business activity in other jurisdictions and evaluate the extent to which market participants transact across multiple jurisdictions.

Changing the culture of regulation

The consultation paper discusses several factors which can contribute to growth in the cumulative burden of regulation. Political urgency to address an emerging social problem can be one cause for rushed heavy-handed regulation. The incentives of different stakeholders involved in regulation – politicians, government agencies, and businesses – helps explain the culture of regulation that we currently have. A strategy for changing the culture of regulation could be informed by framing the regulatory making process as a principal-agent problem.

A practical step that could be taken to improve the culture of regulation is to develop policies encouraging data-sharing between government agencies. Our recommendation to evaluate new business licencing schemes comparing marginal benefits and costs is likely to require agencies to have access to information on other agencies' schemes.

Another practical step is to set a timeline for a review of new licenses that are introduced to ensure that they remain relevant. These reviews should be light-touch and ensure that the original intent of the license is being achieved and that negative unintended consequences are not outweighing the benefits of the license.

RECOMMENDATIONS

- The government should develop policies to encourage data-sharing between government agencies to support a holistic approach to designing regulation
- A timeline for a review of new licenses should be established to ensure that they remain relevant