Business licences and regulation reform

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Moving towards the Productivity Commission

The Federal Government, as part of its broader microeconomic reform agenda, is merging the Bureau of Industry Economics, the Economic Planning Advisory Commission and the Industry Commission to form the Productivity Commission. The three agencies are now co-located in the Treasury portfolio and amalgamation has begun on an administrative basis.

While appropriate arrangements are being finalised, the work program of each of the agencies will continue. The relevant legislation will be introduced soon. This report has been produced by the Bureau of Industry Economics.

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Foreword

Licensing is only one of a wide range of regulatory tools. In *Business licences — International benchmarking*, Australian and overseas licensing systems were benchmarked against a checklist of best practice design criteria. In this volume, licences are compared with alternative regulatory tools. Together, these two reports comprise the first application of the BIE's international benchmarking activities to the regulatory framework services provided by governments to industry.

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Ian Monday
A/g Director

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National Food Authority
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Office of Regulation Review, Industry Commission
The Treasury
Worksafe Australia

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Municipal government agencies:
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Department of Inland Revenue, Ministry of Finance
Department of Labour, Ministry of Human Resources
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Department of Town and Country Planning
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Ministry of International Trade and Industry
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Summary

This is the second volume of a two-part international benchmarking study of business licensing arrangements. In the first volume a checklist of best practice design criteria was established and used to compare Australian and selected overseas licensing systems. The numbers of licences, and applications for licences, typical businesses require in Australian and certain overseas jurisdictions were also compared.

This volume addresses the broader issue of whether, in particular circumstances, licensing is an appropriate regulatory mechanism. Is licensing capable of delivering a larger positive net benefit to the community than any other form of government intervention? Evidence suggests that substantial gains in economic welfare are possible from improving regulatory systems.

International comparisons are made with Canada (British Columbia), Japan, Malaysia (Selangor), New Zealand, the United Kingdom and the United States (Washington State). These countries were selected on the basis of their current or potential economic importance for Australia as trading partners or international competitors. The businesses studied include foundries, seafood processors, retail bakeries, meat processors, petrol service stations and pharmacies.

The licences studied include planning and building approval procedures; various types of retailers', traders', and manufacturers' licences; registrations of premises as shops or factories; permits to use equipment and materials and to discharge wastes; and business name, company and taxation registrations.

Characteristics of licensing

Licensing is only one of a number of means of dealing with the problems associated with spillovers (or *externalities*) and information failures. It will only be the preferred method if it delivers greater positive net benefits to the community than the alternatives. The net benefits of licensing depend on the suitability of its key features in addressing the problem. These key features are:

1. Notification about the business to a licensing agency

Notification is particularly useful when it is important to know the identity of the source of a potential spillover in advance to enable inspections or audits to be conducted. Notification is also used in business name registration systems which guard against the fraudulent or misleading use of trade names. Company incorporation systems also require notification to prevent duplication of company names as well as to provide the public with information about the directors, objects and capital of a new company. Taxation administration and government collection of statistics also rely on notification.

2. Obtaining approval prior to commencing the business activity

This feature is important when externalities or spillover effects are difficult to reverse and probably explains why licensing is a feature of land use and building regulation which controls spillovers from the location decisions of business. It may also be useful when there is a need to reduce risk to negligible levels (such as spillovers which can cause considerable damage).

3. Imposing minimum quality standards

Licensing is often a means of providing consumers with information about the quality of products or service providers, but there may more effective ways of dealing with information problems than licensing.

4. The compulsory nature of licensing

The compulsory aspect of licensing is relevant to the enforcement of licence conditions. Contravention of licence standards may lead to licence revocation and an inability to conduct business. It is also relevant to the competitive environment faced by businesses. Licences may restrict the entry of potential competitors, enhancing the commercial advantage of licensees and imposing unnecessarily high prices on consumers. The compulsory nature of licensing also means that consumers who are not prepared to pay more for higher quality are disadvantaged.

Licences are also frequently used to establish property rights in a previously ‘free’ resource. For example, licences to discharge contaminants may carry rights to trade reductions in emissions below baseline licensed levels; tradeable quotas are also increasingly used in managing the rate at which natural resources such as timber and fisheries are harvested. Provided there are sufficient market participants, a

tradeable permit system can be a highly efficient method of allocating an aggregate limit or quota across licensed businesses.

Licensing and competition

When licensing is exercised by industry or professional associations (*co-regulation*) it may lead to anticompetitive behaviour, for example, through manipulation of entry requirements or qualification standards. Restrictions of this type increase the price of the services of the licensed businesses. These higher prices act like an invisible tax on consumers, transferring income and wealth to licensees and making it difficult to dismantle the licensing system once it is in place.

The Australian Competition Principles Agreement provides for a review of anticompetitive regulatory arrangements by Commonwealth, state and territory governments by 2000. Restrictions on entry imposed under occupational licensing arrangements are relevant to this review. Barriers to entry under licensing can be reduced in a number of ways:

- Licensing agencies which are *independent of the industry or profession* and which include consumer representatives can be used, but they are likely to lack the expertise that co-regulators have in detecting non-compliance.

- Co-regulating agencies may be *registered with an independent body* on condition that they prevent anticompetitive behaviour by their members.

- *Potentially harmful actions*, rather than the professions performing those actions, *may be licensed*. This allows free entry to activities which are not harmful or do not generate spillovers.

- *Negative licensing*, which involves no prior approval but under which poor quality suppliers can be prohibited from trading, is another option. Compared with conventional licensing under a non-trivial entry standard, negative licensing allows more poor quality products and suppliers to begin business. However, resources released from the need to screen applications for prior approval may be directed towards stricter enforcement. There is some limited scope for using negative licensing anticompetitively, for example, if the quality standard which triggers prohibition is set too high.

- *Voluntary accreditation systems* address the public's need for information about the quality of the service without restricting entry of competitors. Businesses are free to seek accreditation (which may be at more than one level of quality or qualification) should they wish but a failure to be accredited does

not prevent the business providing the service and competing with accredited businesses. Because accreditation is voluntary, consumers preferring to exchange lower quality for a lower price are not disadvantaged but uncertainty about quality is reduced.

Other regulatory instruments

In some circumstances, minimum standards and codes of practice may achieve regulatory objectives without the need for licensing. For example, some countries, such as the United Kingdom, require businesses to notify an independent registrar about their use of personal data. Others, such as New Zealand, have favoured a more flexible, and less costly, system of standards for using personal data and which allows businesses to develop codes of practice tailored to their own circumstances. Australia appears likely to follow the New Zealand approach.

Notification alone, rather than licensing, may be sufficient in some instances. For example, in Victoria (Australia) and New Zealand, the use of hazardous equipment requires only notification and assessment of site-specific hazards by the user. In the United Kingdom, even notification has been dispensed with. In New South Wales, health premises licensing has been replaced by notification with inspection occurring after notification and fees being based on the health risk presented by the premises.

Optional prescriptive codes of practice may be useful for businesses lacking the resources to develop and implement their own codes and standards. This may be a particularly important option for small business.

Compulsory contracts may be superior to notifications in some circumstances. In particular, they can provide greater choice and flexibility for employers. Notifications are used in many jurisdictions where employers are required to provide or contribute to workers' compensation insurance, unemployment insurance and retirement pension schemes provided by a monopoly supplier. Many overseas employers are involved more heavily in supplying these services than Australian employers. When Australian employers are required to provide these services, they are increasingly able to do so using a compulsory contract with one of a number of authorised suppliers.

Regulatory flexibility

Developments in licensing are part of a general trend towards greater *regulatory flexibility* in many Australian and overseas jurisdictions. This means that businesses are able to exchange good performance for less prescriptive regulation, or negotiate their own rules with regulators. For example:

- Developers may negotiate planning agreements with local authorities. This may involve the authority relaxing some conditions on the development which would otherwise apply in exchange for improved outcomes for other aspects of the proposal.

- Australian regulatory agencies are using negotiated rule-making in order to offer more flexible regulation in exchange for better practice by regulated businesses. The Altona Chemical Complex best practice regulatory agreement with the Victorian government is a good example of Australian negotiated rule-making in practice. Of the jurisdictions surveyed, perhaps Canada is most advanced in disseminating and applying this approach.

- Licensing may co-exist with voluntary compliance by businesses. The chemical and petroleum industry's *Responsible Care* program augments the existing regulatory framework. It commits producers to a set of principles designed to improve health, safety and environmental outcomes and respond to community concerns about chemicals. The use of *cleaner production* technologies by business is another example of the spread of voluntary responses to the problems associated with externalities.

Implications for regulation reform

In the companion volume to this report, *Business licences — International benchmarking*, a checklist of best practice criteria is developed and used to benchmark the design of licensing systems in Australia and overseas. The analysis in that volume suggested that Australia rated well on supplying information to business about the licences needed to start and run a business, but could do more on integrating and coordinating licence approval systems. It also highlighted some important innovations likely to improve efficiency of licensing systems in Australia, including the introduction of competition among licensing agencies subject to adequate safeguards to protect the public interest.

This report provides an analysis of alternatives to licensing which is complementary to the first volume. Negative licensing and, in particular, accreditation schemes

could solve many problems currently addressed by licensing while fostering competition and expanding consumer choice. Licensing of products and services may be reserved for situations in which the identity of the source of a spillover is important, or when spillovers are difficult to reverse, or when risk must be reduced to an absolute minimum. It also offers a potential means of creating property rights in otherwise ‘free’ resources. Many jurisdictions surveyed, in both Australia and overseas, have foreshadowed reviews intended to remove unnecessary licences.

Standards, codes of practice and compulsory contracts are among other alternatives to licensing and notification which may be able to deliver greater positive net benefits. Australian authorities in many fields have already moved towards the use of these instruments rather than licences or notifications.

It may not be necessary to abandon the licensing of products and services in order to reduce its anticompetitive features. For example, governments could license potentially harmful actions rather than occupations, or could impose constraints on the conduct of co-regulating industry or professional associations.

Summary

More efficient and effective licensing systems can benefit Australia’s competitiveness and welfare. However, licensing is but one of a number of regulatory approaches. Licensing arrangements should be considered on a case by case basis first to determine if any regulation is necessary, and second if licensing is the best option. This report suggests that in a number of instances alternatives to licensing might be the preferred approach.

1 Introduction

This is the second volume in the BIE's international benchmarking study of business licensing arrangements. The first volume, *Business licences — International benchmarking*, compares Australian business licensing arrangements and those in selected overseas jurisdictions with best practice, thereby identifying areas for improvement. A set of best practice criteria for designing licensing systems is developed and applied. These criteria relate to licence application procedures, the standards attached to licences, and licence enforcement strategies. It also examines the numbers of licences to be obtained and applications to be submitted by particular types of businesses before being able to operate.

The focus of this second volume is much broader. Rather than comparing licensing systems in Australia with corresponding systems overseas, it examines situations in which different instruments are used in different countries to achieve similar regulatory objectives. In doing so, it addresses the issue of whether or not licensing is the most appropriate way of achieving specific social and economic objectives. Licensing is thus 'benchmarked' against alternative instruments.

In broad terms, governments may choose regulatory instruments which include licences and permits, fiscal instruments such as taxes and subsidies, or they may promote voluntary mechanisms, including agreements with regulators and voluntary adoption of best practice management. Within these broad categories there are many specific options, such as imposing minimum standards without the need for licensing, or taxing the production of a commodity rather than its consumption. Overseas comparisons highlight the extent to which alternatives to licensing have been adopted and raise important questions about their suitability in Australia.

The purposes of this report are set out in section 1.1. Major themes from recent international regulatory developments are identified in section 1.2. Definitions of licences and notifications and descriptions of other policy instruments studied and compared in the report are reviewed in section 1.3, while section 1.4 contains an outline of the report structure.

1.1 Purpose of this report

The Bureau of Industry Economics' (BIE) international benchmarking project originated in the then Prime Minister's 1991 statement, *Building a Competitive Australia*. Originally focused on infrastructure services, the program was extended in the 1994 *Working Nation* white paper to include general government services to industry.

1.1.1 Benchmarking government services

As discussed in *Business licences — International benchmarking*, there are important differences between general government activities, especially the supply of regulatory services, and the commercial operations of private and public enterprises. In particular, licensing and other forms of regulation involve imposing, manipulating or removing economic constraints on the production choices of businesses and on the consumption choices of households, in order to improve economic welfare for the community.

Consequently, the internal efficiency of regulatory agencies may have a smaller effect on economic welfare than does the nature of the policy instruments used. For example, larger net benefits from pollution control regulations may be more relevant to the community's well-being than increases in the number of pollution licences issued by the relevant agency per staff member. Indeed, if the regulatory agency is using an inappropriate instrument (one that tends to reduce welfare or involve net costs to society), greater efficiency by the agency may make matters worse.

Therefore, this study generally eschews simple measures of agency efficiency. Instead, it focuses on the appropriateness and design of government regulatory services. This approach can perhaps be expressed as a cost-effectiveness approach: given the need to correct for certain market failures, how can this be done at lowest cost to the community as a whole?

Licensing systems and other regulatory mechanisms frequently result in barriers to entry for new firms. This is particularly so when licensing systems are administered by self-regulatory agencies. Barriers to entry enhance the profits or economic rents of incumbents and impose losses on consumers. Licences and regulation generally, by achieving various social and economic objectives, may also deliver important benefits to the wider community.

The balance between these benefits and costs is the primary means of assessing the appropriateness of licensing in this report. Factors influencing the benefits and costs of licensing are highlighted in chapter 2 and are used throughout this volume to assess the appropriateness of licensing in particular circumstances.

The reader should be mindful of the limitations inherent in international comparisons of this kind. Social, cultural and economic priorities which affect the nature of regulation vary widely internationally. The legal systems and traditions within which licensing and other forms of regulation are used also differ. Consequently, regulatory forms which operate effectively in one society may be quite inappropriate in others.

1.2 Regulatory context

The potential gains from improving regulatory systems (of which licensing is a part), while difficult to measure, may be substantial.[1] For example, a survey of United States studies by Hahn and Hird (1991) suggests that, in 1988, the efficiency costs of federal economic regulation[2] alone amounted to around 0.9 per cent of gross domestic product (GDP). Hopkins (1992) estimates the paperwork costs associated with US federal administrative control mechanisms at around 2.2 per cent of GDP in 1990. A survey by Winston (1993) indicates that regulatory reform in the US in the 1980s permanently added as much as 0.8 per cent to the level of annual GDP.

For Australia, Thompson (1989) estimates the compliance and paperwork costs of the main federal regulatory agencies at around 0.7 per cent of GDP. This does not include the efficiency costs of state and local government regulations.

Interest in regulatory reform in Australia and overseas has been prompted by the scope for economic gains just discussed, together with the progressive decline in barriers to international trade. As businesses are increasingly exposed to overseas competitive pressure, domestic impediments to efficiency and productivity are highlighted. Since 1985 eighteen OECD countries have begun or expanded regulatory reform programs (Jacobs 1992). These programs have tried to simplify and reduce the number of rules, to consolidate and eliminate laws, to encourage

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[1] In Australia, a summary of recent estimates of the economic effects of various reforms is contained in Industry Commission (1995b). For a contrary view in the Australian context, see Quiggin (1996).

[2] In the United States, a distinction is drawn between *economic regulation*, which means the regulation of commercial activities in a particular industry and from which it is argued there are few social benefits, and *social regulation* affecting several industries and possibly delivering substantial benefits to the community (Hahn and Hird 1991). Examples of social regulation include environmental emission restrictions, occupational health and safety laws and consumer protection regulations.

mutual recognition of standards, increase reliance on market incentives, and to insist on stronger justifications for proposed new regulations.

The OECD has been disseminating information about regulatory reform among member states. It has also sponsored research on the development of efficient public institutions in the former communist nations of eastern Europe.

The European Commission has introduced measures requiring the economic evaluation of any new regulations likely to be particularly burdensome on business. Product testing standards and regulation in the EC was made more flexible during the 1980s. Most recently, the Molitor expert group provided general proposals for simplifying regulation and administration in a number of key areas (EC 1995).

The United Kingdom now requires proposals for new regulation to be assessed by proposing departments in the context of the compliance burden imposed on industry. Similarly, significant new federal regulations in the United States must be reviewed in terms of costs and benefits by the Office of Information and Regulatory Affairs. The New Zealand government is currently undertaking work to reduce the costs to business of complying with regulation.

In Australia, regulatory review processes have been initiated or expanded by Commonwealth, state and territory governments. Australian concern with regulatory review since the early 1980s has been part of a broad-based microeconomic reform program designed to encourage improvements in economic performance. This represented a response to the deterioration in the performance of the highly protected and regulated mid-century Australian economy relative to much of the rest of the world. The BIE’s international benchmarking studies for infrastructure services had shown that by the early 1990s there were large gaps between Australian electricity, waterfront and rail freight suppliers and world best practice in terms of price, performance reliability and productivity (BIE 1994). The microeconomic reform program has progressively exposed Australian industry to greater international competition. Regulatory review is an important ingredient in that program.

This study should be viewed in the context of the licence rationalisation programs currently being conducted in many jurisdictions, including a number of Australian states and territories. It is possible that these programs will conclude that many existing instances of licensing cannot be justified because there are alternative regulatory mechanisms which are likely to be just as effective but which will impose lower costs on the community.

The report is also relevant to concerns that small business bears a disproportionately large regulatory burden. This may reflect the fact that many regulatory requirements have a ‘fixed’ compliance component which is independent of the scale of the business. In the United Kingdom there are requirements for separate consultation with small business on the impact of a proposed regulation to ensure the views of small business are taken into account. However, there has also been pressure to remove exemptions from regulation for small business because they may create regulatory thresholds which inhibit the expansion of businesses.

Finally, licensing issues should be studied along with trends in the general regulatory context. Particularly relevant are the emerging concepts of *negotiated rule-making* and *regulatory flexibility*. These are being applied in Canada and are gaining rapid acceptance in many other jurisdictions. Also relevant is the increasing use of *voluntary agreements* between regulators and businesses, and the development of *voluntary standards* superimposed on the existing regulatory framework. All of these affect the usefulness of licensing as a regulatory instrument.

Australian and overseas regulatory developments are described in the appendix.

1.3 Definitions

The definitions relevant to this report are set out in more detail in the companion volume, *Business licences — International benchmarking*. The formal definitions are repeated in box 1.1. The essential properties of a ***licence*** are:

- *notification*
  - information is supplied to a specified agency;
- *prior approval*
  - approval from a specific agency is obtained before commencing the prescribed business activities;
- *standards*
  - minimum standards are to be complied with; and
- *enforcement* or *compulsion*
  - licensing is not voluntary so that conducting the activities without a licence is unlawful, the standards are legally enforceable, and contravention of

them may lead to the suspension or revocation of permission to conduct the activity.

A ***notification*** involves the first and fourth properties. While a specific standard may not be involved, compliance with more general requirements may be associated with a notification. For example, company 'registration' requires directors and officers of the company to comply with the relevant companies legislation.

Box 1.1 Definitions of licences and notifications

Notification

An instrument created under government authority requiring all businesses with specified characteristics to provide information about their attributes to a specified agency.

Licence

A notification which also requires prior approval as a condition for conducting prescribed business activities, and compliance with specified minimum standards — breaches of which may result in the suspension or revocation of permission by a specified agency.

A licence or notification need not be administered by a government agency, but it must be created under government authority, that is, by legislation, regulation, ministerial order, by-law or similar legal process. Therefore, licences and permits may be issued by industry associations (under 'co-regulation') or by private certifiers authorised by law (such as the private building approval certifiers now operating in some Australian jurisdictions) as well as by government agencies. The standards need to be minimum requirements but not necessarily uniform across different businesses. They may reflect differences in the circumstances of individual businesses.

In contrast to licences, notification schemes may not involve any scrutiny of the business and may be implemented mainly to reduce the administrative costs of identifying and locating firms. Distinguishing between licences and notifications is often difficult in practice. 'Licences' may require only the most basic quality standards to be met or involve only the most cursory examination of an application. These are almost indistinguishable from notifications. For this reason, licences and registrations are close regulatory cousins and are considered jointly in this study.

Examples of items which fall within these definitions of licences and notifications are planning and building approval procedures; various types of retailers', traders',

and manufacturers' licences; registrations of premises as shops or factories; permits to use equipment and materials and to discharge wastes; and business name, company and taxation registrations.

The following are possible alternatives to licences and notifications:

- ***Accreditation*** or ***certification*** schemes which amount to non-mandatory licences. They involve prior approval and compliance with minimum standards and accreditation can be withdrawn for failing to satisfy the standards. However, lack of accreditation does not prevent a firm from lawfully engaging in the relevant business activity. Many critics of licensing systems (for example, Moore 1961) favour accreditation as an alternative to licensing.

- ***Negative licensing*** systems in which no licence or permit is required before commencing operations but a business committing serious breaches of the required standards may be barred from continuing the activity.

The properties of licences, notifications, accreditations and negative licences are summarised in table 1.1.

Table 1.1 Properties of licences, notifications, accreditations and negative licences

Property	*Licence*	*Notification*	*Accreditation*	*Negative licence*
Notification	✓	✓	✓	
Prior approval	✓		✓	
Standards	✓	†	✓	✓
Enforcement or compulsion	✓	✓		✓

† = optional

Also excluded from the definitions of licences and notifications are:

- ***Compulsory contracts***. These arise when firms are required to engage one of a number of possible (private or public) contractors as a condition of conducting business and there is no requirement to supply a government agency with evidence of the contract. If the contract must be registered or notified the arrangement is a notification. Two examples illustrate the difference.

  – If firms may exercise choice over their compulsory workers' compensation insurer, the insurance is a compulsory contract. If, however, there is only one insurer, operating under a public monopoly, it seems too contrived to regard the arrangement as a 'contract' — for all practical purposes it is a notification.

- Laws requiring businesses to dispose of solid effluent with a private or public waste management business of their own choosing involve compulsory contracts. But ‘contracts’ to discharge trade waste into a public sewerage system are more realistically regarded as licences if there are no practical alternatives to this form of waste disposal.

- ***Standards***. A code of practice is an example of a standard without an associated licence. Its provisions may be voluntary or compulsory. It does not require businesses to obtain prior approval.

- ***Property, product liability and labelling laws***. These are laws which establish and protect property rights or require information to be supplied to consumers. They relate to, for example, transfers of land, copyright, trade marks and patents, as well as statutory warranties and requirements to label food and drug products. They do not involve prior approval.

- ***Government franchises***. These include the prerequisites for obtaining government tenders or undertaking government franchises or monopolies. Private firms may choose whether or not to tender to supply services to or on behalf of the government. In many countries, these arrangements may also be termed ‘licences’.

- Approvals for ***access to utilities*** such as electricity, water, gas and telephone. In most cases these resemble the purchase of any other commodity. In many jurisdictions, the building approval process includes application procedures for connecting a new or renovated structure to utility services. These are outside the scope of this study.

- ***Equipment operator licences*** and similar qualifications. These affect the characteristics of employees selected by the firm rather than represent a requirement to be satisfied by the business. However, licences which must be obtained by a proprietor, partner or major shareholder in the business are included. This is often the case with occupational licensing (for example, in most jurisdictions, only licensed pharmacists may operate a pharmacy).

- ***Company accounting returns, taxation returns*** and ***statistical returns***. These returns are not a condition for operating the business. However, the requirements for incorporating a company and initial notifications to taxation authorities are included in the study.

1.4 Outline of this report

Chapter 2 contains a discussion of the common explanations for the existence of licensing systems. These include correcting market failures (especially externalities and information failures), enhancing the market power of licensed businesses as a means of securing redistributions of wealth and income, and various paternalist motives.

The circumstances under which licensing is likely to deliver relatively large net benefits to the community, and therefore be the most appropriate regulatory mechanism, are examined in chapter 3.

Licensing systems and their alternatives in practice are examined in chapters 4, 5 and 6, using examples drawn from Australia and overseas. The problems caused by licensing as a barrier to the entry of new firms is discussed in chapter 4 in the context of the licensing of health professionals, with pharmacies providing a working example. Innovative developments in professional licensing in Canada are examined along with the scope for using accreditation systems in place of licensing.

The role of standards and codes of practice as alternatives to licensing is discussed in chapter 5 in three contexts: the regulation of the use of personal information by businesses; the regulation of hazardous equipment; and the licensing of food premises. Chapter 6 contains a discussion of the role of compulsory contracts as alternatives to notifications in such areas as workers' compensation insurance and social security and pension arrangements.

Chapter 7 includes a broader discussion of the regulatory framework within which licensing operates. The concept of regulatory flexibility is introduced along with various alternative regulatory mechanisms such as voluntary agreements between regulators and businesses and industry-initiated standards which overlay the existing regulatory framework. The chapter also includes a discussion of moves towards rationalising the numbers of licences in a number of jurisdictions.

The implications of the study for Australia are canvassed in chapter 8.

END OF CHAPTER

1 INTRODUCTION 1

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2 Explanations for licensing

Licensing is only one form of government intervention in business activities. In this chapter, explanations for the use of business licensing are examined.[1] The intended and unintended consequences of licensing are also discussed. This provides some necessary background for discussing whether or not intervention is warranted and whether or not licensing is the most appropriate form of intervention (chapter 3).

Some common explanations for the use of business licensing are, broadly:

- to account for spillover effects or *externalities*;
- to address *information failures*;
- to restrict competition and enhance market power; and
- paternalism.

The first two involve correcting *market failures*, that is, situations in which competitive markets are unable to deliver socially optimal outcomes. They are often the explicit objectives of licensing schemes. The third is a potential outcome of licensing and may or may not be an objective. The last may often be an implicit motive for licensing.

2.1 Externalities

Externalities or 'spillovers' occur when the actions of producers or consumers result in uncompensated benefits or costs to others. Spillovers may be positive or negative. The classic example of a *positive externality* is the benefit conferred on orchardists from the pollinating activities of bees owned by apiarists. A factory polluting a river may be an example of a *negative externality*. If a river is freely available for use by anyone, there is no potential constraint on the volume of waste a factory discharges into it. In this case, the actions of the factory 'spill over' onto other users of the river. Pollution reduces the value of the river as a source of drinking water or as a venue for recreation. These costs are external to the factory in

[1] *Explanations* for the existence of licensing may or may not justify its use in particular circumstances.

the sense that they are not taken into account when it decides how much output to produce or waste to discharge.

This divergence between private and social costs and benefits means that a non-optimal (from a social point of view) level of the spillover-generating activity will occur. The correction of uncompensated (positive or negative) external effects of private activities is a common justification for government intervention.

The most efficient policy response to an externality such as pollution is often characterised as one which equates the cost of preventing an additional unit of pollution (the *marginal abatement cost*) with the social damage it would cause (the *marginal social damage*).

There are different ways for regulators to try to achieve this end. Some ways are more costly than others. If the authorities had perfect information about the costs and benefits of controlling such externalities, they could apply emission limits at the level of pollution at which the marginal abatement cost was equal to the marginal social damage for each business. These ideal circumstances are rarely encountered in practice. Instead, legislators often specify emission limits which provide, for example, adequate margins of health and environmental safety (Tietenberg 1992, p.369).

These limits may take the form of maximum emission rates with which each firm must comply or of an aggregate requirement for an entire community. By requiring all polluting firms in a community to obtain a licence, control can be exercised over the maximum level of local emissions. Licences may carry rights to trade in emission entitlements leading to a cost-effective allocation of an aggregate community limit across individual businesses (see chapter 9 of the companion volume, *Business licences — International benchmarking*). Licences may also be used to enforce limits, through the threat of suspension or revocation, and may also provide a mechanism for prior approval to check that the equipment and technology to be used by each firm is likely to keep emissions within licensed limits.

For these reasons, licences may be an appropriate means of addressing externalities. However, other economic instruments such as standards, taxes and subsidies may be capable of delivering greater net benefits than licences.

2.2 Information failures

An *information failure* does not necessarily arise simply because businesses and consumers have less than perfect information. Ideally, information should be acquired until the cost of obtaining more outweighs the expected benefit from doing

so. Information failures occur when information is inadequate with respect to this optimal level. It is useful to distinguish three broad types of information failures: asymmetric, deficient and biased information.

Information asymmetries arise when one of the parties engaged in a transaction (for example, buyer or seller, employer or employee) holds insufficient information to enable a socially optimal outcome to be achieved. For example, if the buyer of a product is unable to readily assess its quality until after it is bought, he or she may be unwilling to pay any price premium for a product of superior quality. By the same token, sellers of higher quality goods will be unwilling to trade if buyers are unable to recognise quality characteristics. Akerlof (1970) showed that, in these circumstances, less of the product may be traded than is socially desirable.

Information asymmetries might also encompass cases of deliberate fraud (Moore 1961, p.104). In an attempt to minimise the scope for fraud, licensing might be used to remove from the market, goods and services which consumers would not knowingly or voluntarily purchase (Kleinig 1983, p.188). It may also attempt to remove suppliers who are not of ‘good character and temperate habits’, provide a cheaper remedy to fraud than litigation, and help to track down offenders (Moore 1961, p.105).

Information deficiencies occur when all parties to a transaction lack sufficient information to arrive at a socially optimal decision. For example, employers and employees may be unaware of the risk of using certain equipment or processes. These types of deficiencies may justify government programs designed to provide information about workplace safety and dangerous products.

Information biases occur when the parties have flawed information, including incorrect risk perceptions. These may, for example, affect the supply of safety in different contexts. Consumers may overestimate the health risks associated with some food products, or inputs to those products (for example, additives), yet underestimate the risks of others (for example, diet-related heart disease). These biases in perception may lead to too much or too little safety, compared with that supplied and demanded on the basis of unbiased information.

Licences may address information failures by acting as signals. They can be used to indicate that a product or service satisfies certain minimum standards of quality, safety or some other desirable attribute. This may be particularly relevant to transactions involving what are described as *experience* goods, the quality of which can only be evaluated during the course of their use (Nelson 1970). Most services would qualify as experience goods. Information failures may also be associated with using so-called *credence* goods, the effects of which may only appear years later (Ogus 1994, pp.132–3). Other examples include expensive, one-off purchases

of used equipment, where the seller's experience with the equipment is more reliable than any test the buyer can perform, and services of a technical nature, where the supplier is a better judge of the quality of his or her services than the buyer. As Leland (1979, p.1330) notes:

> A poor plumbing job might not show up for several years, and there might then be doubt as to whether it was caused by the plumber, by misuse, or by an 'act of God.' The plumbing jobs performed by physicians are presumably even more difficult to assess.

Simply providing additional information to consumers to rectify an information failure may not be appropriate because information is costly to process and interpret. Kleinig (1983, p.185) argues that:

> We are assailed on every side by information, and find that in order to handle it in the time at our disposal, we have to be selective in our sources and in the kinds of information that we attend to. … Even where we have plenty of data, it may not be in a form that we need. … Sometimes the information is available but may not be accessible for cost reasons. … Much product information is supplied by manufacturers/sellers — understandably so, because they are best suited to providing it. But they are also interested in sales, and information tends to be presented 'persuasively.' It needs to be discounted or approached *cum grano salis.*

In these circumstances, licensing may be a relatively inexpensive means for consumers to obtain the information they need about suppliers and products.

Intervention may also be considered when differences between expert and public perceptions of risk reflect poor quality information rather than cultural values (such as risk preferences). Licensing, in particular, may help to allay possibly irrational fears.[2]

The distinction between information failures and externalities, while useful, is not always clear cut. Ogus (1994, p.217) observes that:

> … a poorly designed or constructed building may create risks for users of the building who were in no way involved in the original dealings with an architect or engineer; an incompetently drafted will or conveyance may impose losses on individuals far removed from the negligent solicitor; and a failure by a doctor in treating a contagious disease may give rise to an epidemic.

Clearly, information failures may provide grounds for licences. However, other mechanisms such as voluntary accreditation schemes, negative licences, advertising laws, product liability laws and statutory warranties may also address information failures and may do so more efficiently than licensing.

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[2] Ogus, personal communication 9 February 1996.

2.3 Competition and market power

Licensing may also be used, intentionally or unintentionally, to create or enhance the influence of businesses over consumers of their products and suppliers of their inputs. Economists would probably regard the use of licensing systems to enhance market power as unjustified.

Licensing may restrict competition by:

- imposing stringent standards on new entrants;
- limiting the number of businesses which may supply a market; and/or
- controlling the use of specific inputs, for example, through controls on the use of land and buildings.

The explicit justification often used for licensing in the first two circumstances is the removal of dangerous or very low quality goods and services from the market. However, the same ends may be achieved through means other than licensing which do not enhance the market power of certain businesses. These issues are raised in chapter 4.

The third situation includes planning and building controls which may create shortages of suitable commercial locations. They may thus enhance the economic leverage of businesses which have managed to secure an appropriately zoned location. Excessively restrictive quotas on the use of natural resources may have a similar effect. Issues in land use planning control are discussed in the companion volume, *Business licences — International benchmarking*.

The anticompetitive consequences of licensing may lead to redistributions of income and wealth, especially when licensing results in restraints on the supply of goods and services. Much professional and occupational licensing has been criticised on this basis. If the future economic advantages of the licence are expected to persist, they may be capitalised into the market value of the licence which becomes a valuable asset in the hands of the licensee.

For example, in Australia the Industry Commission (1994b) stated that the most noticeable effect of government regulation of the taxi industry was the high value of taxi licences due to the restriction on taxi numbers. The high monetary value of licences may require taxi operators to charge higher prices. The restriction on the number of licences may enable these higher prices to be charged.

The existence of valuable rights in licences can be a major impediment to their removal (Ogus 1994, p.220). Furthermore, the incentive to oppose income and wealth transfers associated with licensing is usually weak because the wealth transfers are generally not recognised and the public cannot easily identify their size (van den Bergh and Faure 1991, p.177).

2.4 Paternalism

Paternalism has been roughly defined as 'interference with a person's liberty of action justified by reasons referring exclusively to the welfare, good, happiness, needs, interests or values of the person being coerced' (Dworkin 1971, p.108).[3] There are at least two possible explanations for licensing based on paternalistic considerations: the vulnerability of some purchasers in the market; and the related issue of the capacity of sellers to manipulate the preferences of purchasers.

2.4.1 Purchaser vulnerability

It is sometimes argued that the purpose of licensing suppliers of goods and services is to secure a minimum level of quality or safety to protect some consumers who are gullible, preoccupied or careless or who miscalculate. Kleinig (1983, pp.183–4) puts it this way:

> The end is not to eliminate choice (or the lessons that may be learned from misguided choices), but to remove from the market choices that will more than likely be made only by those who are susceptible to nonmaximizing considerations. … given the comparative advantage that sellers have with respect to knowledge about their products, and given the weaknesses and vulnerabilities of potential customers, minimum quality and safety standards (and occupational licensing) represent an attempt to overcome the worst effects of exploitation.

However, these potential problems may be addressed through means other than licensing, such as statutory warranties and product liability laws which may carry less danger of unnecessarily entrenching economic power in the hands of licensed suppliers.

[3] There may be some debate about whether coercion is necessary.

2.4.2 Preference manipulation

In section 2.2 it was suggested that advertising by sellers was unlikely to provide an adequate solution to significant information failures. Advertising may also exploit emotional vulnerabilities among consumers, so that uncomfortably high levels of caution must be exercised in market transactions (Kleinig 1983, p.186–7). However, economists would probably reject this as being sufficient reason to impose minimum standards in commercial transactions, whether or not through licensing. If exploitative advertising is a problem, it may be simpler and more effective to legislate against such conduct than to impose minimum standards on advertised goods and services through licensing.

Purchaser vulnerability and preference manipulation alone do not appear to be sufficient to justify licensing but they may provide additional support for other motives such as the need to correct spillovers or information failures.

2.5 Summary

Licensing is one of a number of potentially justifiable economic instruments for addressing the problems of externalities and information failures.

However, economists would regard other explanations for licensing systems with concern. If licensing is used mainly to increase market power by restricting entry it is likely to encourage collusive behaviour at the expense of consumers and to impede innovation and efficiency on the part of licensed businesses. Licensing as a means of transferring income and wealth to firms with licences from the rest of the community is also questionable. The existing taxation and social security system is partly designed to effect such transfers more transparently and with greater certainty.

The ability of licensing to correct an externality or information failure may need to be set against its anticompetitive potential. Indeed, there are often important tradeoffs between the benefits provided by licensing in reducing externalities or information failures and the costs which result from restricting competition. Paternalist explanations, while relevant, are generally inadequate to justify licensing unless spillovers or information failures are also being addressed.

In chapter 3, factors which influence the appropriateness of licensing as a means of government intervention are discussed.

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3 When is licensing the best way?

Government intervention in business activities is often justified as a means of securing economic and social objectives through which additional benefits, in the form of greater welfare, are conferred on the community. Examples of these objectives include helping markets work efficiently, protecting consumers, preserving public resources, safeguarding the environment and maintaining workplace health and safety.

Intervening in commercial activities may also impose costs on businesses and the wider community. Sometimes the benefits may be less than the costs so that intervention may not be justified. Sometimes there may be methods of intervention which can deliver greater net benefits than those currently in use. The suspicion that this may be commonplace has prompted many governments to review their regulatory processes, as discussed in chapter 1.

Circumstances in which licensing is likely to be the most appropriate means of achieving particular regulatory objectives are examined in this chapter. These are situations in which licensing is likely to deliver larger positive net benefits to the community than are alternative economic instruments. Alternatives to licensing are explored. The concepts of externalities, information failures, market power and paternalism introduced in chapter 2 are used to identify circumstances which may or may not favour the use of licensing as a regulatory form. The issues discussed here are applied in chapters 4, 5, 6 and 7 to describe the use of alternatives to licensing and the overall regulatory context within which licensing is applied in Australia and overseas.

3.1 Net benefits and the characteristics of licensing

Licensing may be justified if it delivers positive net benefits to the community. However, even then it may not be the form of government intervention which provides the largest net benefit. Given the scope of this study, formal benefit–cost analysis is not used. Instead, the emphasis is placed on the key characteristics of licensing as a policy instrument and the specific circumstances in which it is being used to determine whether or not licensing is likely to be the most appropriate solution. Examples are drawn from Australia and overseas.

The extent to which the characteristics of licensing are likely to provide an efficient and effective means of addressing problems caused by externalities and information failures is described in the following sections. The four characteristics providing the basis for this discussion are (see also chapter 1):

- the requirement to notify an agency about the attributes of the business;
- the need to obtain prior approval;
- the mandatory nature of licensing; and
- the use of performance or quality standards.

3.2 Notification

Requiring businesses to supply information to an agency means that such agencies obtain a complete list of possible business sources of externalities and information failures within their jurisdiction. This means licensing agencies can better direct inspection and audit resources. For example, agencies may use information about the location and activities of businesses to help target enforcement towards riskier businesses or activities.

However, while the mandatory supply of information helps to reduce agency enforcement costs, it adds to the private costs associated with complying with information requests, completing application forms or engaging consultants to gather data required by agencies. The agency also incurs costs of processing and storing the requested information. Instead of the mandatory supply of information, there are alternative methods of improving the efficient use of enforcement resources. For example, instead of initiating inspections of businesses on the basis of notified information, agencies may prefer to respond to complaints about contraventions of standards or laws. When is collecting information as part of a licensing system likely to be preferable?

Compulsory provision of information as part of a licensing system is more likely to produce net benefits when it is important to know the identity of the source of a potential externality in advance. For example:

- most planning and building control involves licensing and permit arrangements requiring the supply of a considerable amount of site-specific information;
- food premises are usually registered with local health authorities to enable inspections or audits to be conducted. Food control agencies typically do not

rely solely on complaints, presumably partly because they perceive larger social benefits from pre-emptive enforcement; and

- controls over hazardous substances involve supplying information to a notification agency to allow it to track and account for quantities of the material manufactured or imported.

In other cases, the identity of the business may be needed, for example, to reduce tax evasion, to ensure that business and company names are unique within each jurisdiction, or to compel businesses to obtain certain services (such as workers' compensation insurance or pension schemes) through public monopoly agencies.

3.3 Prior approval

This section discusses how the anticipatory nature of licensing affects the delivery of net benefits when dealing with externalities and information failures. The main advantage of insisting on prior approval is the opportunity to test or inspect all businesses wishing to engage in the licensed activity and detect and thereby exclude poor quality or otherwise unsatisfactory activities or applicants. If licensing is to be justified the social benefits need to be sufficiently large to offset the cost of assessing every applicant.

3.3.1 Irreversible externalities

The licensing of suppliers of goods and services and of the products they supply is sometimes justified on the basis that it corrects externalities associated with their use. For example, one argument for licensing physicians is to eliminate poor quality practitioners who, should they diagnose a disease incorrectly, may fail to prevent an epidemic. However, as Moore (1961, p.110) observes:

> To complete the argument, it is necessary to contend that this is more likely or more damaging than the possibility that, if the inexpensive medical practitioner is made unavailable, the consumer will neglect to consult a physician at all, thus starting an epidemic.

Moore concludes that, except in the possible cases of physicians, veterinarians and pharmacists, it is unlikely that occupational licensing can be justified on the grounds of addressing externalities.

A stronger case might be mounted if licensing were a cheap and effective means of avoiding externalities which would otherwise be difficult or costly to reverse. Land use planning and building approval systems are an example. The relative

permanence of roads and other transport routes means that property markets are slow to adapt to shifts in demand and any resulting spillovers may only be reversible at very high cost (Ogus 1994, pp.239–40). It is more cost-effective to minimise the potential for spillovers before development begins.

3.3.2 Location-specific social benefits

In some cases, physical separation of activities generating and affected by externalities is the most practical solution. For example, the marginal benefit from controlling the noise emanating from a factory near residences may be substantially greater than the marginal benefit of noise control near other factories. It may also be much higher than the marginal cost of the maximum feasible level of noise abatement the factory could install. In this case, the factory would be unable to restrict its noise to an optimal level.

A simple and practical solution is to require the factory to locate next to other industrial premises where the social damage of an additional noisy factory is much lower. This would be implemented through a locational licence or land use permit system. Modern outcome-oriented planning systems may allow a factory near a residential area if its effects on residential amenity do not exceed certain thresholds.[1]

3.3.3 Fixed spillovers

There may be an important fixed component of a spillover which is unrelated to the scale of the business's activity. For example, even quite small amounts of some highly toxic substances are capable of causing considerable damage to the environment. The problem of preventing leakages of used nuclear reactor fuel from storage sites into subterranean watercourses is a case in point. In these cases the marginal benefit from reducing the risk of an accident may be negligible unless the risk can be eliminated. There may be no feasible level of risk at which a net benefit can be secured.[2] A tax on the spillover is unlikely to achieve a socially optimal level of the activity. Even if very large sanctions may be incurred under private tort law or conventional safety regulations, they may be inadequate if the possibility that the firm will incur the sanction is very small. It may be rational for the firm's managers to gamble that 'the tiny risk will not materialize and simply declare the firm

[1] See the companion volume, *Business licences — International benchmarking*. Factories near the edges of industrial zones may need (and are often subject to) additional controls.

[2] This class of problem was first identified by Starrett (1972).

insolvent should it do so' (Ogus 1994, p.228). Licensing or some other form of direct regulation may be the only effective means of addressing such an externality.

3.3.4 Limits on the use of property rights

In the absence of prohibitively high transactions costs, voluntary mechanisms to overcome negative externalities (such as private agreements between individuals) may arise in an efficient, competitive market. However, government intervention may be required to establish the appropriate conditions for their operation. Examples of naturally occurring voluntary mechanisms which overcome externalities include:

- a voluntary agreement by beekeepers to supply pollination services to orchardists; and
- a voluntary agreement among the separate owners of land sharing a common resource (such as a subterranean water supply) to exploit it at a sustainable rate.

In many cases establishing property rights might be appropriate. These may include private legal rights such as actions in tort for personal injuries as well as the ability to avoid contracts where consent was based on mistake or fraud.

Voluntary mechanisms may also include private rights to exploit an otherwise free resource, or to prevent such a resource being used. Affected parties may then be able to trade these rights to achieve a mutually satisfactory outcome. However, there are often practical difficulties with this approach. If there are too many parties, agreement is difficult to reach. If there are too few parties, there may be strategic behaviour which leads to less than optimal outcomes.[3]

For example, spillovers experienced by residents from the industrial development of adjacent properties could be reduced by legally enforceable covenants permitting only residences on every parcel of land in a neighbourhood. However, these are normally applied at the time of subdivision of the land because to do so subsequently would require agreement among too many individual landowners (Ogus 1994, p.240). Consequently, they will fail to respond to changing economic circumstances.

A locational licensing (planning permit) system is likely to be more flexible. Licensing may also be used to establish property rights in a previously 'free'

[3] For example, if there is only one business purchasing the right to discharge effluent into a stream but many affected households, the business may exert inordinate influence over the outcome compared with a situation in which there are many parties on both sides of the negotiating table.

resource, as in the case of tradeable licences to discharge pollution into the air or a watercourse.

3.3.5 The precautionary principle

Where there is limited knowledge or understanding about the potential for, or risk of, spillovers, precautionary action may be justified by the balance of costs and benefits. This action may include licensing. For example, it is common to find that controversial scientific developments, such as conducting research on human embryos, are subject to licensing specifying the terms under which such research may take place and the credentials of those proposing to conduct the activity.

3.3.6 The role of negative licensing

Under negative licensing schemes, an individual or business is permitted to undertake a commercial activity without any test of competence. However, if it is subsequently determined by an agency that the business has failed to meet a minimum quality or performance standard, the right to conduct the activity may be withdrawn (Ogus 1994, p.222).

By definition, negative licensing must allow more unacceptably low quality suppliers and products than licensing. However, negative licensing allows public resources which are devoted to handling notification and prior approval under a licensing system to be redirected to enforcement of the standard.

For a given administration cost, one way of comparing the effects of negative licensing and traditional licensing is to consider the probability that a consumer will receive unacceptably low quality products. If the decreased risk of consuming poor quality products outweighs the increased risk from having more poor quality suppliers, negative licensing is preferable to traditional licensing (ORR 1994).

Negative licensing also allows free entry into the market. However, this may be open to abuse if the standard which triggers the withdrawal of permission is set too high. Compared with licensing, it involves no private and public costs of notification and prior approval. While there are no licensing or application fees, the public cost of enforcement must be subsidised through taxation.

Victoria (Australia) uses negative licensing for the regulation of sub-agents in real estate.

3.4 Mandatory nature

The mandatory nature of licensing means that businesses cannot choose whether or not to achieve the performance standard or level of quality specified in the licence. It also means that consumer choice is limited to licensed businesses. Voluntary mechanisms, which may or may not be sponsored by governments, may achieve the objectives of licensing without reducing the choice available to businesses and consumers.

3.4.1 The role of accreditation schemes

Licences may address information failures by acting as signals (section 2.2). However, voluntary accreditation or certification systems may also provide indicators of quality. These differ from licensing systems because it remains lawful to engage in an activity even though unaccredited. According to Ogus (1994, p.217), accreditation:

> … possesses the additional advantage of preserving freedom of choice: consumers who want to can elect for a lower quality of service at what will be a lower price.

It also allows free entry into the market and so is less likely to hinder competition (Wolfson et al. 1980, p.204).

Accreditation provides at least as much information as licensing and potentially much more. Licensing gives no information about the difference between practitioners above the minimum entrance requirements. Moore (1961, p.104) notes that under accreditation:

> … those practitioners who desired to be certified and who could meet certain standards, including the passing of an examination, would be given a certificate of approval. … Certification would therefore appear to satisfy the lack of information hypothesis better than licensing.

By excluding lower quality suppliers from the market, licensing reduces uncertainty about the quality of the products supplied, and may contribute to social welfare. This benefit is more likely to be realised when licensing is cheaper than leaving consumers to acquire information about products and suppliers on their own. This is more likely to be the case when (Moore 1961, p.105):

- there is a large variation in the quality of the product or supplier (which raises the cost of obtaining information);
- the potential damage from poor quality is great;

- evaluating the service requires great technical expertise; or
- the consumer has little direct contact with the supplier.

However, licensing also raises the price of the product and this imposes a welfare loss because some consumers may not be prepared to pay for the higher quality. Whether there is a net welfare gain is problematic (Leland 1979).

Because accreditation is non-mandatory, consumers preferring to trade off lower quality for lower price are not disadvantaged but uncertainty about quality is still reduced. However, this does not mean that accreditation is preferred to licensing in all circumstances. For example, it may be argued that consumers systematically under-estimate the probability of harm from low quality products. Consequently:

> … licensing is justified for those occupations most subject to certification under the lack of information hypothesis. (Moore 1961, p.106)

That is, it is most readily justified for those occupations for which the variation in quality is large, or the potential damage from poor quality is great, or much technical expertise is needed, or where the level of consumer contact with the supplier is low.

3.4.2 The role of other mechanisms

There are a number of other means of addressing information failures. The law of contract in many jurisdictions now recognises that commercial transactions contain implied warranties by sellers concerning the quality of a service. There may also be statutory warranties which sellers cannot avoid. However, it may be difficult and expensive to determine whether the quality actually supplied is sufficiently low to represent a breach of implicit or explicit warranty. For example, litigation concerning professional malpractice can be complex and protracted (Ogus 1994, p. 217). The absence of warranties may be a signal of low quality products. The effectiveness of a warranty depends among other things on the credibility of the firm supplying it and the costs of pursuing a claim (Cooper 1992).

Information failures have given rise to non-regulatory solutions such as brand names, trade marks and franchise arrangements. These represent means of signalling quality to potential consumers. An even more widespread means of addressing potential information failures is advertising. Advertising has often been prevented in the professions, apparently magnifying the extent of the information failure and strengthening the justification for professional licensing. Removing restrictions on advertising may reduce the apparent benefits from, and need for, licensing.

The removal of advertising restrictions may also benefit consumers. For example, conveyancing fees declined when English solicitors were allowed to advertise (Domberger and Sherr 1989). United States evidence suggests that fees for ordinary legal services were 5 to 13 per cent lower in states with relatively few restrictions on advertising.[4]

Product liability laws may also be considered as an alternative to licensing. The most appropriate form of these laws depends on a number of issues. If losses arise solely from the quality of the product (and not from its use by consumers) a *strict liability* regime may provide producers with an incentive to supply a level of quality closer to the social optimum.[5] If *negligence* rather than strict liability applies, producers will tailor the level of quality of their products to the standard of care required by the courts, which may be more or less than optimal.[6] When the possibility of losses arising from consumer misuse arises, producers subject to negligence actions are likely to over-engineer products. In such cases, everyone may be better off if the courts recognise contributory negligence on the part of consumers.

Governments may also choose to ban products outright, but prohibitions are costly to enforce and costly for consumers if they must pay a higher price for unwanted levels of safety (Swinbank 1993; Leland 1979). Prohibitions are more likely to be appropriate in more extreme cases of information deficiencies, such as the unwitting sale of dangerous toys by retailers.

3.5 The level of standards

In this section the anticompetitive effects of licensing standards are examined more closely. Excessively high standards tend to reduce the net benefits available from licensing. Barriers to entry may be erected by agencies concerned with licensing of occupations and professions (especially when they are influenced by industry and professional groups, as in co-regulation systems). Excessively stringent standards may also be applied to licensed products. These restrictions produce transfers of income (in the form of *economic rent* which exceeds the normal rate of return to a

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4 Federal Trade Commission (Bureau of Economics), 'Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising', Washington D.C., cited in Young (1987, p.66).

5 *Strict liability* means that the consumer need only prove that a product defect caused loss.

6 When *negligence* applies, producers may avoid liability even though loss occurred if they can prove they satisfied the standard of care required by the law.

business) to the licensees and permit holders, and general efficiency losses from a less competitive economic environment.[7]

Inappropriate controls or standards concerning the use of inputs to businesses, such as the use of land and buildings or access to resources, may also be responsible for inefficiencies. For example, a failure to provide an adequate quantity of land suitable for commercial development may lead to wasteful geographical concentrations of economic power. Similarly, an inappropriately restrictive aggregate emission quota under a tradeable permit system will impose excessive costs on affected businesses while making individual permits more valuable.

3.5.1 Occupational licensing

Occupational licensing is characterised by regulation of entry and may also control competition among members of the licensed occupation. Occupational licensing arrangements provide opportunities for practitioner incomes to be enhanced and for their employment security to be increased. The heavy investment by some professions in training, and the risks associated with increased specialisation have led some to suggest that occupational licensing may also represent a form of *career insurance* (Benham 1980, p.14).

Occupational licensing is commonly advocated as a means of correcting information failures about the quality of professional service. Its value in this regard is open to dispute. For example, licensing may increase the supply of high quality suppliers and so reduce the costs of searching for information on the part of consumers who prefer high quality. However, consumers seeking lower quality service at a lower price will be disadvantaged by licensing (Young 1987, p.20). Most of the objectives of occupational licensing systems, with respect to addressing information failures, could be accomplished by accreditation schemes (see sub-section 3.5.4).

Furthermore, the extent of information failures relevant to many professional services is debatable. For example, surveys of clients confirm that they regularly assess the quality of professional services. Major clients, such as corporate clients of lawyers, or local authorities which engage architects, are likely to have few information problems, partly because they have sufficient resources to undertake the search for information. Professional services are often subject to repeat purchases so that, for example, a patient may be able to judge the quality of a

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[7] There may also be cases in which a licensing system is clearly intended to discourage the licensed activity. Moore (1961) provides the example of itinerant peddlers of drugs in late nineteenth century Chicago who were charged the exorbitant licence fee of $1000 per month.

physician's treatment. Finally, the increasing admission of advertising by professional bodies suggests that they believe consumers can compare their services with those of substitutes (van den Bergh and Faure 1991).

Occupational licensing carries important implications for competition and market power. Barriers to entry may be indirect. For example, while there may be no specific limits to the total number of entrants, this does not prevent examination standards being raised to restrict entry (Ogus 1994, p.225). There is some United States evidence from the 1970s which suggests that failure rates on professional and trade licensing examinations were correlated with national unemployment rates for much of the century, suggesting that entry standards are raised when employment prospects deteriorate in order to preserve incomes.[8] Maurizi (1974) found statistical evidence that state licensing boards in the United States often adjusted the pass rates on licensing examinations in order to prolong the period of high incomes resulting from increases in the demand for the services of the occupation.

In the United Kingdom, the Deregulation Task Force observed that:

> There are currently over 250 different business licences. … the obligation to obtain a licence before trading is additional to the regulatory regime that applies after trading begins. Even if one accepts the case for regulating each of these economic activities it is hard to see why businesses should have to plead to the authorities for a licence before they can even start. The system advantages existing businesses who hold licences at the expense of those seeking to start up. The requirement to hold a licence is a barrier to market entry, and inhibits innovation, growth and consumer choice. We believe there should be a presumption that each one of these licences should be abolished unless a powerful argument for its retention can be made. (UK DTF 1995, p.9)

The report noted that licences for some types of business premises, notably pubs and pharmacies, may be refused if the relevant authority decides there is no 'need' for an additional facility. However, the task force noted that if there is no 'need' for the facility, it will go out of business and that consumers, rather than the authorities, should decide what premises are needed and where. It recommended that these 'need' tests be abolished.

Licensing of many other occupations also enhances market power of incumbents and leads to redistributions of wealth towards them. For example, the high value of taxi licences in Australia has been put forward as symptomatic of an industry in which licensing has been used to erect substantial barriers to entry and reduce competition to the disadvantage of consumers. Existing licence holders have an

[8] Rayack, Elton 1976, 'An Economic Analysis of Occupational Licensure', Report prepared for the United States Department of Labor, cited in Young (1987, p.39).

interest in opposing any increase in numbers. The Australian Trade Practices Commission submission to the Industry Commission inquiry into urban transport stated that:

> The strict control over entry, through a licensing mechanism, has meant that the right to operate a taxi, known as a 'plate', has been bid to very high levels … The capitalisation of these monopoly rents in the form of high plate prices contributes to higher taxi fares to the extent that plate owners need to earn a commercial rate of return on their capital investment in the plates as well as in the car. Regulatory reforms which make taxi plates more freely available to applicants who meet minimum entry standards would reduce the capital value of the plates and result in lower fares in a more competitive taxi market. (Industry Commission 1994b, vol.1, p.392)

The Industry Commission recommended that all state and territory governments initiate a program of progressively selling new taxi licences until no further bids are received. At that point, new licences would be issued on demand at no more than their administrative cost (Industry Commission 1994b, vol.1, pp.404–5).

3.5.2 Land use controls

Excessive restrictions on the supply of land for development can achieve substantial redistributions of wealth. An example is provided by the planning controls on petrol service stations in the Australian Capital Territory (ACT). The Industry Commission (1994c, p.184) observed that:

> Canberra has been a planned city since its inception with sites earmarked as service stations and released by public auction. The majority of sites are located in neighbourhood shopping centres rather than on the main thoroughfares. With both the number and location of service stations restricted, sites in the Australian Capital Territory (ACT) fetched high prices, reflecting the benefits they conferred on the lessees.

These restrictions are combined with regulations prohibiting advertising of petrol prices on major roads. The Commission reported the conclusions of a study by the Commonwealth Prices Surveillance Authority that consumers pay between three and five cents per litre more for petrol as a direct result of ACT planning policies.

3.5.3 Tradeable permits

Quotas imposed under tradeable permit or licence systems and designed to address externalities may also entrench established firms if the quotas are unreasonably low. For example, pollution emission limits could be allocated to firms and be traded

among polluters.[9] Trade would be allowed in all or part of the allocated limit. Under competitive conditions, trade continues until the price of a unit of emission equals the cost of abating that unit. At this point each firm is indifferent between incurring extra expenditure to prevent a given additional amount of pollution and purchasing an emission credit allowing the same incremental discharge. This will be optimal if the marginal cost of abatement equals the marginal social damage from pollution. If the total emission limit is below the optimum, firms will incur excessive costs in controlling pollution with emission permit prices being bid up.

3.5.4 Quality declines as supply cost rises

One instance in which the combination of minimum standards and licensing may be highly effective has been identified by Leland (1979). This is the case in which increases in the cost of supplying a service are associated with *reductions* in its quality. In such cases licensing and minimum quality standards may be quite useful. For example, the supply of blood products by donors may deteriorate if it is sourced from paid suppliers rather than voluntary donors. A licence which screens out low quality suppliers may be welfare-improving in these circumstances.

3.6 Summary

Licensing is one of a number of means by which the problems associated with spillovers and information failures may be dealt with. The effectiveness and efficiency of licensing as a form of regulation depends on its ability to deliver net benefits to business and the wider community, and to provide larger net benefits than alternative methods of achieving its objectives. The likelihood of these benefits depends on the relevance of the key characteristics of licensing (notification, prior approval, compulsion and standards) to the purposes for which licensing is being used.

Notification (whether or not it is part of a licensing system) is more likely to be useful when it is important to know the identity of the source of a potential externality in advance. Permit and notification systems for land use, building, food hygiene and hazardous goods may be justifiable on this basis. Notification is also important in the administration of taxation. It may also be relevant to other compulsory requirements such as workers' compensation and pension arrangements provided by public monopolies.

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[9] Of course, the initial allocation of the aggregate limits affects the value and viability of existing firms.

Prior approval may be relevant when externalities are difficult to reverse, or when they are location-specific or unrelated to the activities of a business. It may also be useful when there is limited knowledge about the risks associated with a spillover. These considerations also suggest that licensing is likely to remain important in the areas of land use and building control. Licensing is also likely to be applied to activities involving controversial scientific, moral or legal issues.

The mandatory nature of licensing may be more difficult to justify when it is used to address information failures involving the quality or performance of products and services. Voluntary accreditation schemes may satisfactorily address information failures without reducing business and consumer choice. However, licensing may be preferred to accreditation when there is evidence that consumers underestimate the potential harm from poor quality products and the product is subject to wide variations in quality; when the potential harm is great, or it is difficult to evaluate the product; or when the consumer has little contact with the supplier.

Negative licensing probably has a smaller information content than either licensing or accreditation but retains the flexibility of accreditation.

In assessing the likely benefits from licensing, interactions with other government interventions (such as restrictions on advertising) should not be ignored. The need for licensing may be reduced if these restrictions are modified or removed.

In addition to limiting choice, licensing systems are also capable of enhancing the market power of certain businesses and this may be associated with redistributions of income and wealth. This is more likely when licences involve explicit or implicit quotas on the numbers of businesses which may engage in the activity, or when standards are manipulated to regulate the rate of entry of new businesses. Examples include the licensing of occupations and professions, the application of land use controls and the use of tradeable permit systems.

The principles summarised here are applied in chapters 4, 5 and 6. In chapter 4, the effects of licensing as a barrier to new entrants in an industry are examined using the health professions, and pharmacists in particular, as an example. The use of standards, codes of practice and similar regulatory devices as alternatives to licensing is the subject of chapter 5. In chapter 6, the use of compulsory contracts as alternatives to notifications in Australia and overseas is examined using workers' compensation and social security arrangements as examples.

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4 Removing barriers to entry

Licensing suppliers and products is one means of addressing information failures and possibly spillovers. However, licensing may reduce competition among the licensed businesses by raising barriers to the entry of new suppliers. Examples of such barriers include high standards for admission to a profession or trade, lengthy educational and training requirements, and quotas on the number of licences issued.

In this chapter these barriers are discussed in the context of the licensing of health professionals, especially pharmacies. The retail pharmacy industry in Australia is an interesting case because it has undergone extensive restructuring in recent years and its regulation is closely connected with government policies concerning the public subsidy of retail pharmaceuticals.

Under the Competition Principles Agreement (CPA), the Commonwealth, state and territory governments accept that legislation should not restrict competition unless it can be demonstrated to confer net benefits on the community and the objectives of the legislation can only be achieved by restricting competition (CPA 1995, s.5(1)). The governments agreed to implement a review of restrictions on competition to be completed by the year 2000 (CPA 1995, s.5(3)). It is expected that anticompetitive occupational licensing arrangements will be reviewed as part of this process (Industry Commission 1995b, p.103). Any licensing arrangements with anticompetitive implications in the retail pharmacy industry may be subject to review in the near future.

In section 4.1 the role of co-regulation and the scope for licensing to be used to restrict entry is discussed in the context of the licensing of pharmacies. Recent innovations in the co-regulation of other lawyers are also examined. Section 4.2 contains an overview of restrictions on the operation of pharmacies in each Australian state and territory and New Zealand. New approaches to pharmacy licensing in Canada are examined in section 4.3.

4.1 Co-regulation, licensing and entry restrictions

Direct regulation by industry associations combined with government oversight or ratification (*co-regulation*) is often used to control the conduct of professions.[1] Licensing or notification may also be involved in these arrangements. For example, pharmacists in Australia are licensed by government agencies but their counterparts in New Zealand are licensed by an industry association. These systems are outlined in box 4.1. Lawyers in Victoria are co-regulated but a recent report to the government recommended the introduction of a new regulatory structure to overcome perceived deficiencies in the system (box 4.2).

Box 4.1 Pharmacy licensing in Australia and New Zealand: government regulation and co-regulation

In many Australian jurisdictions the professional licensing of both pharmacists and pharmacy premises is administered by a self-funding government pharmacy board. These boards are statutory bodies under the direct or indirect control of the state health department. For example, in Queensland, health professional registration boards, including the Pharmacy Board, have powers to make regulations in the form of by-laws covering administrative and procedural issues, professional advertising and the use of professional titles. The board also administers by-laws prescribing the academic and practical experience required to obtain a licence as a pharmacist.

The Pharmaceutical Society of Australia is a voluntary national professional association rather than a co-regulator. Similarly, The Pharmacy Guild of Australia comprises practising pharmacy owners and is also not involved in regulatory activities.

By contrast, in New Zealand, regulatory functions are performed by a non-government agency, the Pharmaceutical Society of New Zealand (PSNZ). The PSNZ derives its regulatory powers from the *Pharmacy Act 1970* and regulations. The society confers licences on pharmacists by administering the regulations governing academic and practical experience.

The role of the PSNZ is much wider than administering regulation. It makes submissions to government on behalf of pharmacists, sometimes in conjunction with the Pharmacy Guild (the body which represents employer pharmacists), and also coordinates a public health information program. The society is also formally associated with the School of Pharmacy at the University of Otago, which confers the country's sole graduate qualification in pharmacy.

Inspections and audits by co-regulators are probably more effective than those by government agencies because members of the industry are better placed to detect

[1] Arrangements described here as *co-regulation* are described as self-regulation by some commentators. For example, van den Bergh and Faure (1991, p.173) state: 'The final step is self-regulation. Whereas licensing rules are issued by public authorities, regulation of both entry and performance is now issued by the profession itself. At this stage the professional association becomes a public body'.

breaches of compliance and cover-ups than government inspectors. The members of a profession have a better knowledge of the quality of services they provide so that the profession itself has the best capacity to control service quality and identify low standards (van den Bergh and Faure 1991, p.173).

However, abuses can occur if associations are undemocratic, or are writing as well as interpreting and enforcing rules (Ogus 1994, p.108). Also, non-professionals (such as consumer groups) are typically not represented in professional or industry associations. This can be overcome when direct regulation through a government body is used instead.

Box 4.2 Co-regulation of lawyers in Victoria

The issue of co-regulation has recently been raised in respect of Victorian lawyers. Two co-regulating bodies are involved:

- the Bar Council, which is the governing body of (and which is elected by) the Victorian Bar, a voluntary association of lawyers who choose to practice only as barristers; and
- the Law Institute, which is a statutory body incorporated under the *Law Institute Act 1917*, regulating solicitors and barristers who choose not to be regulated by the Bar Council, and whose Council has powers under the *Legal Profession Practice Act 1958* to make rules regulating the conduct of members (subject to disallowance by the Governor in Council).

A recent review of these regulatory arrangements concluded that day to day regulation is best performed by the legal profession, subject to strong accountability mechanisms, but that the public should be able to set the broad parameters for regulation. It recommended a *Legal Practice Board* (LPB) be established to be responsible for the registration of recognised professional associations (RPAs) and to oversee the rules of professional conduct made by those associations. The LPB would be at arm's length from both the government and individual practitioners.

The criteria for registering RPAs would include membership eligibility requirements that are not unduly narrow and rules that are not anticompetitive in effect. A *Legal Ombudsman*, a statutory officer independent of the RPAs and responsible for the general supervision of the legal profession in the public interest, would continuously scrutinise anticompetitive practices in the profession.

Source: Victorian AGWP 1995.

Co-regulating professional bodies also lack appropriate incentives to control and enforce quality standards. They may wish to give the impression that the services of all professionals are equally good because they wish to exclude competition on service characteristics (van den Bergh and Faure 1991, p.174). Because co-regulation usually excludes non-practitioners, there is a potential risk of co-regulators using their powers to restrict entry for the benefit of existing members. Evidence of abuses of co-regulatory arrangements in many fields are documented in sub-section 3.5.1.

The arguments are summarised by the Victorian Attorney-General's working party on the legal profession which is currently co-regulated in that jurisdiction:

> Critics of the present regulatory structure argue that there is an insoluble conflict of interest between a professional organisation's role as representative of its members and its role as regulator of its members. Supporters argue that the system is more effective and efficient than any government agency that might be proposed as an alternative and, provided that there are strong controls to monitor the regulatory performance of the professional organisations, is more accountable than any such agency could be. (Victorian AGWP 1995, p.27)

The working party made a number of innovative recommendations which attempt to combine those features of co-regulation and government regulation which are in the best interest of the community. These might be broadly described as developing a system of co-regulation with public interest safeguards. Specifically, it recommended the establishment of a *Legal Practice Board* (LPB) independent of government and the professional associations. Lawyer's professional bodies would seek registration as *recognised professional associations* (RPAs) provided, *inter alia*, their rules were not anticompetitive. Anticompetitive behaviour would be continuously monitored by an independent *Legal Ombudsman*.

Co-regulation would continue to the extent that RPAs would frame rules for members and enforce them but would be accountable through the LPB registration system based on monitoring by the Legal Ombudsman. The working party recommended that the LPB prescribe general principles with which RPA rules must be consistent. For example, one of these principles might be to generally prohibit conflicts of interest and this would guide the RPAs in formulating detailed practice rules for their members.

This proposed Victorian system demonstrates the opportunities for redesigning co-regulatory systems so that their benefits (effective and efficient auditing and inspection) may be preserved while lessening the risk of professional associations engaging in anticompetitive behaviour.

4.2 Other restrictions associated with licensing

In addition to the constraints on entry associated with professional licensing, there are sometimes direct restrictions on entry and limitations on the nature and extent of ownership. In the case of pharmacies, these include restrictions on new pharmacies applied through the distribution of Pharmaceutical Benefits Scheme (PBS) approvals (section 4.2.1), and controls on the numbers of pharmacies which may be owned and the form of ownership (section 4.2.2).

4.2.1 Geographical entry restrictions

In Australia, a new pharmacy can only be established if the Health Insurance Commission is convinced there is a need for one in a particular location. This restriction is the result of a pharmacy restructuring program initiated by the Commonwealth in 1990. It operates through the Health Insurance Commission's control over the distribution of PBS approvals. Pharmacies require this approval because of the importance of the financial contribution to their income from PBS prescriptions.

This type of geographical licensing is difficult to justify in any situation. It is not clear why the Health Insurance Commission should have better information than the industry about the commercial viability of particular sites as locations for pharmacies. The system has the potential to set up a spatial monopoly for some existing pharmacies, which is likely to inhibit competition and increase the price of pharmaceuticals.

In the United Kingdom, similar geographic licensing restrictions have applied to pharmacies. New pharmacies are permitted by the relevant authority only when it believes there is a 'need' for the service at a particular location. These restrictions were opposed by the Deregulation Task Force (UK DTF 1995). The task force noted that consumers rather than the authorities should determine whether there is a 'need' for the facility (see sub-section 3.5.1).

4.2.2 Ownership restrictions

Restrictions on the number of pharmacies owned by a pharmacist may prevent the realisation of economies of scale which would reduce unit operating costs. Only two Australian jurisdictions have no such restrictions. However, none of the

Australian restrictions appears to be as severe as that in New Zealand, where the policy is effectively *one (owner) pharmacist — one pharmacy* (see table 4.1).[2]

Prohibitions on non-pharmacists owning pharmacies means that competition from some people with skills in management and retailing is absent, and the potential for combining pharmacies with other retailing operations to reduce unit costs is unavailable (Evans 1980). There may also be restrictions on the ownership form of pharmacies. In most Australian jurisdictions, companies are prohibited from owning pharmacies.

Table 4.1 Restrictions on pharmacy ownership

Jurisdiction	*Number of pharmacies a pharmacist may own*	*Corporate ownership*
New South Wales	3	Not permitted
Victoria	3	Not permitted
Queensland	4	Not permitted
South Australia	4	Permitted
Western Australia	2	Not permitted
Tasmania	2	Not permitted
Australian Capital Territory	Unlimited	Not permitted
Northern Territory	Unlimited	Not permitted
New Zealand	1	Permitted

Sources: Queensland Health (1994); New Zealand *Pharmacy Act 1970*; New South Wales *Pharmacy Act 1964*.

Corporate ownership is permitted under the recent South Australian legislation. A company may be registered as a 'pharmacist' provided:

- its sole object is to practice as a pharmacy, including a business commonly associated with a pharmacy;
- no shares are owned other than by pharmacists (either directors or employees) or their relatives;
- all directors are pharmacists (except that if there are only two directors, one may be a relative) and only these have voting rights; and
- a pharmacist may not be a director of more than one pharmacist company without prior approval.

[2] Under the New Zealand *Pharmacy Act 1970*, no person other than a pharmacist can hold an interest in a pharmacy and no person can hold an interest in more than one pharmacy.

In New Zealand, where corporate ownership has been permitted for some years, a pharmacist company must be at least 75 per cent owned by pharmacists and effective control of the company must be vested in those pharmacists. Also, no member of the company can be the proprietor of any other pharmacy or of any other pharmacist company.

In 1985, the BIE reported that there were few ownership restrictions on pharmacies in most major developed countries. Canada, Japan, the United Kingdom and the United States only required that a pharmacist be employed in the pharmacy (BIE 1985).

Prohibitions on company ownership may limit the ability of pharmacy businesses to expand by restricting access to capital, and deny them the potential benefits of a limited liability ownership structure.

The Industry Commission estimated that removing the geographic monopoly of existing pharmacies and removing the restriction limiting the number of pharmacies a pharmacist may own could reduce the overall retail margin on pharmaceuticals by 15 per cent (Industry Commission 1995b, pp.124-5).

4.3 Scope of practice statements and licensed acts

Reforms to the licensing arrangements for health professionals in Ontario, Canada provide some innovative ideas on ways to reduce the anticompetitive effects of licensing while maintaining public confidence in the safety of services.

Before the reforms, two classes of regulated health professions were recognised in Ontario — licensed and accredited. The distinction broadly reflects the definitions used in chapter 1. Members of licensed professions had an exclusive monopoly to practice. Members of other professions could seek accreditation should they wish but it was not necessary in order to practise. Licensed professions, including pharmacy, were co-regulated by the relevant professional colleges. This two-tiered system led to demands by the accredited professions to become licensed in order to secure monopoly advantages. The previous regulatory structure of Ontario is set out in table 4.2.

Concern about anticompetitive aspects of the licensing of health professionals in Ontario led to a lengthy review of that province's licensing arrangements.[3] The new arrangements are '… aimed at advancing the public interest, not the interests of the

[3] The review began in November 1982 and culminated in the proclamation of new legislation on 31 December 1993.

professions' (Ontario HPLR, p.2). They are intended to protect the public from incompetent health care providers while allowing consumers freedom to choose their health care provider within a range of safe options.

Table 4.2 Previous regulatory arrangements for health professionals, Ontario, Canada

Unregulated	*Regulated under Drugless Practitioners' Act 1925*	*Regulated under individual statutes*	*Regulated under Health Disciplines Act 1974*
	Licensed (monopoly) or accredited (no monopoly)		Licensed (monopoly)
audiologists	chiropractors	chiropodists	dentists
dieticians	masseurs	dental technicians	dental hygienists
medical laboratory technologists	osteopaths	ophthalmic dispensers	physicians
midwives	physiotherapists	psychologists	nurses
occupational therapists		radiological technicians	optometrists
respiratory technologists		denture therapists	pharmacists
speech language pathologists			

Source: Ontario HPLR.

There are three key elements in the Ontario reforms:

- precisely defining the *scope of practice* of each profession;
- the identification of *licensed acts* for each profession; and
- an overarching prohibition on persons other than regulated health professionals performing potentially harmful acts (whether or not they are licensed acts).

These elements are discussed in more detail below.

4.3.1 Scope of practice statements

The traditional approach to regulating health professions, such as that used in Queensland, defines the profession broadly in the regulatory legislation and prohibits others from engaging in its practice (see box 4.3). For example, in

comments which echo those of the Ontario review, Queensland Health noted that:

> … it is very difficult to police and enforce provisions restricting broad areas of practice to registered practitioners. In practice, registration boards have had to rely on complaints to identify illegal practitioners. Resource constraints and technical difficulties in proving illegal practice have further limited the boards' ability to pursue these complaints in the courts. (Queensland Health 1994, Attachment 6, p.5)

Box 4.3 Scope of practice and licensed acts

The *definition* of the practice of pharmacy in **Queensland, Australia** is:

- the professional dispensing of medicines, mixtures, compounds and drugs; and
- where appropriate, the sale of items of trade and the provision of services in conjunction with the professional dispensing of medicines, mixtures, compounds and drugs:

It excludes the lawful sale of patent or proprietary medicines by retail shopkeepers.

Under the new regulatory arrangements for health professions in **Ontario, Canada**, the statement of the *scope of practice* for a pharmacy is:

- … the custody, compounding and, upon the order of a practitioner legally qualified to prescribe drugs, the dispensing of drugs, the provision of non-prescription drugs, health care aids and devices, and the provision of information related to drug use.

A key difference between the jurisdictions is that the Queensland definition specifies the set of licensed acts for a pharmacy, while the scope of practice statement in Ontario is merely a general description of the profession's activities which are not restricted to pharmacists.

The Queensland definition leads to the licensing of a relatively broad range of activities, some of which may not be harmful. In Ontario, there is a separate list of specific potentially harmful acts which are licensed. In effect, the licensed activities of pharmacists are defined more narrowly, and the scope for competition is wider, in Ontario than Queensland.

Sources: Ontario *Pharmacy Act 1993*; Queensland *Pharmacy Act 1976*.

Licensing the scope of practice has been argued to be anticompetitive and inefficient in a number of other ways (Queensland Health 1994, Attachment 6). It:

- restricts consumers in their choice of health care providers because other professional groups may be able to provide certain services more efficiently;
- prevents other competing professions from expanding their scope of practice; and

- discourages innovation in the provision of health services and the growth of new professions.

In the Ontario reforms the scope of practice for each profession is defined but not licensed. That is, the scope of practice is not restricted to that profession (see box 4.3). For example, for pharmacists 'the provision of information related to drug use' is a component of the scope statement, but is not limited to pharmacists or other health professionals. Anyone could provide such information without breaching the *Pharmacy Act 1993*.[4] Only licensed acts are regulated (see sub-section 4.3.2).

The *Health Professions Regulatory Advisory Council* provides a forum for professions to discuss the demarcation lines between professions' scopes of practice. The ultimate authority over professional boundaries resides with the provincial government through its power to amend the legislation governing each regulated profession.

4.3.2 Licensed acts

Instead of licensing the scope of practice, the Ontario reforms involve identifying and licensing a list of acts and procedures which are potentially harmful. These appear in the Ontario *Health Professions Procedural Code*. This means that non-harmful acts are not licensed. Thus, the licensing system is more closely focused on the particular information failures and externalities associated with potentially harmful acts or omissions. In the code, the licensed acts are linked to the registration of each profession with the relevant co-regulating agency (s.1.01(e)):

> … a certificate of registration issued under an Act governing a health profession … authorizes the holder of the certificate to use the protected title(s) and to perform authorized licensed acts in the course of practising as a member of a health profession …

The Ontario *Medicine Act 1993* contains the entire list of licensed acts. Other professions are entitled to practise a subset of this list (or are allowed no licensed acts at all). This means that the authority to perform some licensed acts may be shared among professions. For example, physicians and dentists, as well as pharmacists, may dispense drugs provided the dispensing is for their patients.

[4] Information from Ontario College of Pharmacists, 5 February 1996.

Thus, the licensed acts, rather than a broad statement of the scope of practice, provide the basis for restricting the economic activities of potential competitors. The Ontario legislation is likely to allow greater competition between health professionals on two counts:

- competitors may engage in non-harmful (unlicensed) acts which might have been restricted if the scope of practice were licensed; and
- other licensed professions may engage in the same licensed acts provided they are authorised by legislation.

4.3.3 Harmful acts

The Ontario reforms also recognise that harm may be caused through unlicensed acts. Therefore, there is a general prohibition on persons other than licensed professionals acting within their relevant scope of practice from performing potentially harmful acts. The Ontario *Regulated Health Professions Act 1991* provides that (s.30):

> No person, other than a member treating or advising within the scope of practice of his or her profession, shall treat or advise a person with respect to his or her health in circumstances in which it is reasonably foreseeable that serious physical harm may result from the treatment or advice or from an omission from them.

This provision is intended to prevent unqualified caregivers causing harm without actually performing a licensed act. There are various specified exceptions, including rendering first aid in an emergency.

Certain titles used by health professionals continue to be protected in Ontario. For example, the titles *apothecary*, *druggist*, *pharmacist* and *pharmaceutical chemist* may by law only be used by a member of the Ontario College of Pharmacists. In Queensland, it is an offence for an unregistered person to use the titles pharmacist, chemist or pharmaceutical chemist or any other name which could imply the person is a pharmacist or is practising pharmacy (Queensland Health 1994, Attachment 6).

4.3.4 The role of accreditation and liability rules

The health profession regulation reforms in Ontario provide a number of innovative means of reducing the anticompetitive effects of professional licensing. They could be applied to other professional groups. However, entry restrictions, and the scope for unrecognised income and wealth transfers, remain intact.

If information failure is the major problem in regulating professions, then it is possible to sympathise with the view of van den Bergh and Faure (1991, p.173) that:

> … the first step the legislator has to consider is promulgation of regulations that make the provision of information compulsory. Mandatory disclosure is foreseen by many so-called Consumer Protection Acts. … The second step is quality regulation, direct or indirect through liability rules. … It involves the setting of safety and health standards by the government or a regulatory agency.

Presumably, these measures should also include removing any general prohibitions on professional advertising.

As discussed in chapter 3 there is also a case for liability rules when information failures are being addressed.

4.4 Summary

Licensing of professionals such as pharmacists may be conducted through co-regulating professional associations, as in New Zealand and Ontario, Canada, or through government bodies as in Australia. Co-regulation includes the potential for more efficient enforcement of standards but carries risks of abuse by the co-regulating body. However, it may be possible to design co-regulatory systems so that the risk of anticompetitive behaviour is lessened. For example, in Victoria, Australia, it has been proposed that the current co-regulatory system for lawyers be augmented by requiring the relevant professional associations to be accredited with an independent board on condition that their rules not be anticompetitive. The system would be further safeguarded through continuous independent scrutiny of the competitive behaviour of the profession.

Australian pharmacies are subject to a number of restrictions in addition to those imposed by their professional requirements. These include controls over the entry of new pharmacies, and over the numbers of pharmacies which may be owned and their legal form. These restrictions appear generally difficult to justify.

Innovative developments in Ontario, Canada provide useful ideas for ameliorating some of the anticompetitive effects of professional licensing. These include a shift in emphasis away from licensing the broad scope of practice of the profession and towards licensing the specific acts and procedures which may potentially cause damage or harm.

However, other measures also have considerable potential to reduce information failures without restricting competition in the way that professional licensing does.

These include removing prohibitions on professional advertising, requiring the compulsory provision of information about service quality, the enforcement of standards (without notification or licensing), and the use of accreditation schemes.

END OF CHAPTER

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5 Standards and codes of practice

Minimum quality standards may be set without the need for licensing. Licences involve the additional requirement of prior approval and carry the additional sanction of termination or suspension of approval.

The term *standard* is used in a general sense in this report. It covers all mandatory and voluntary quality requirements. Mandatory standards may appear in statutes, regulations, statutory instruments, ministerial orders and other legally enforceable instruments. Voluntary standards include the recommendations of technical organisations, including standards associations and laboratories (*technical standards*), as well as *codes of practice* endorsed by industry associations or individual businesses.

Technical standards tend to be highly prescriptive and specific to types of production processes, equipment and the like. They are not subject to benefit–cost analysis, nor to the extensive public comment and review processes applied to regulations. Technical standards may also become effectively mandatory by being referenced, wholly or partly, in regulations which carry the force of law.[1]

In this chapter the role of standards as alternatives to licences is discussed in a number of contexts. Section 5.1 contains a comparison of licensing, notifications and codes of practice to regulate the use of personal data by businesses used in different jurisdictions. The use of notifications, standards and codes of practice in the regulation of hazardous equipment is discussed in section 5.2. Finally, the replacement of food premises licensing with a notification system, which involves increased reliance on the enforcement of standards, in New South Wales is examined in section 5.3.

[1] In the United Kingdom, the term *code of practice* refers specifically to a set of formally binding rules issued by a regulatory agency. The term *authorised code of practice* refers to a commentary on a statutory instrument (regulation) in non-legal language providing practical guidance about how regulations apply to different circumstances and which alternative methods may be adopted to comply with them. In Australia, codes of practice are not regarded as setting technical standards but rather as a means of providing detailed and practical advice in the same way as does a United Kingdom authorised code of practice.

5.1 Personal data protection

Businesses are often required to meet standards or follow guidelines concerning the protection of personal data acquired through, or used in, the normal course of business. In some countries, notably New Zealand, standards governing personal data have been developed with scope for industry-specific codes of practice to be introduced on a consultative basis. Similar approaches are being considered in Australia. The existence of such approaches raises doubts about the need for licensing or notification systems used to protect private data in the hands of business such as those operating in the United Kingdom, France, Ireland and the Scandinavian countries.

5.1.1 OECD Guidelines

The OECD (1980) has a set of basic principles for the use of personal data. These serve as minimum standards for the protection of privacy. They have influenced the development of privacy laws internationally (box 5.1).

5.1.2 New Zealand codes of practice

In New Zealand the *Privacy Act 1993* applies to both the public and private sectors. There are no notification or licensing provisions for private businesses. However, there are information privacy principles with which private firms must comply. The principles reflect the OECD guidelines and concern the collection, storage, use, access, correction and disclosure of personal information whether held in manual or computer files.

Proceedings against a private firm using personal information may begin when an individual alleges that there has been an 'interference' with his or her privacy.[2] Complaints are lodged with the *Privacy Commissioner* who may investigate them and act as a mediator to try to achieve a settlement.[3] The legislation makes extensive use of alternative dispute resolution procedures. For example, the commissioner may convene a compulsory conference of the parties to the dispute for the purpose of mediation.[4] If a settlement cannot be reached, the matter may be

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[2] This includes a breach of an information privacy principle which causes loss, detriment, damage or injury, or adversely affects the individual's rights, benefits, privileges, obligations or interests, or results in significant humiliation, loss of dignity or injury to feelings of that individual (*Privacy Act 1993*, s.66).

[3] *Privacy Act 1993*, s.63.

[4] Ibid.

referred to the *Proceedings Commissioner* who decides whether to bring the matter before the *Complaints Review Tribunal*.[5]

Box 5.1 OECD guidelines governing the protection of privacy

The OECD guidelines apply to personal data in the public or private sectors which pose a danger to privacy and individual liberties because of the manner in which the data are processed or their nature or the context in which they are used. They are paraphrased below:

Collection limitation. The collection of personal data should be limited and be obtained lawfully and fairly and, where appropriate, with the knowledge or consent of the data subject.

Data quality. The data should be relevant to the purposes for which used and be accurate, complete and kept up-to-date.

Purpose specification. The purposes for collecting the data should be specified before collection and their use should be consistent with those purposes.

Use limitation. The data should not be disclosed or used for purposes other than those specified at the time of collection except with the data subject's consent or by lawful authority.

Security safeguards. The data should be reasonably protected against loss or unauthorised access or modification.

Openness. There should be ready means to determine the existence and nature of personal data, the main purposes of their use and the identity of the data controller.

Individual participation. Individuals should be entitled to:

- obtain advice about whether the data controller has data about them;
- obtain data relating to them in a reasonable manner;
- receive reasons for any refusal to supply advice or data and be able to appeal against refusal; and
- challenge data and, if successful, have the data erased or amended.

Accountability. A data controller should be accountable for complying with these principles.

Source: OECD (1980).

[5] The legislation renamed the Equal Opportunities Commission as the *Complaints Review Tribunal* to deal with civil proceedings initiated under the act. The constitution of the tribunal is contained in the New Zealand *Human Rights Commission Act 1977*. The remedies available to the tribunal include a declaration that the individual's privacy has been interfered with, an order restraining the defendant from interfering or requiring the defendant to remedy the interference, damages, or 'such other relief as the Tribunal thinks fit' (s.85(1)(e)).

The New Zealand legislation provides an interesting use of codes of practice which reflects some elements of the concept of *regulatory flexibility* discussed in chapter 7. The information privacy principles may be modified by codes of practice issued by the Privacy Commissioner acting on his or her own initiative, or on the application of any person. The provisions of the legislation dealing with breaches of principles then apply to breaches of the code of practice.[6] These codes of practice may represent the interests of a class of businesses, or of any industry, profession or calling or even an individual firm or activity.[7] This arrangement can accommodate different circumstances within the private sector. For example, a code may apply to an entire industry, or an entire sector (which might include more than one industry). A code may also apply to a single agency within an industry, a particular activity carried out within the industry, or a class of information handled by the industry (perhaps together with other industries). Because all codes are based on a single set of principles, they constitute a consistent and coherent approach across the private sector.

5.1.3 Australian proposals

In Australia, the Commonwealth *Privacy Act 1988* incorporates Information Privacy Principles which also reflect the OECD principles. They mainly apply to the Commonwealth public sector. Private sector coverage is limited to the handling of tax file numbers and consumer credit information. There are no notification or licensing provisions involved and no general business standards controlling the storage and use of personal data.[8] Currently, there are few instances of codes of practice for handling personal data.

As part of the 1995 Innovation Statement the then Commonwealth government announced its intention to review information privacy arrangements in the Australian non-government sector in response to growing community concern about the effect of information services on the privacy of data and personal information. It proposed consulting with business, consumer groups and state and territory governments as well as examining overseas privacy laws to develop a privacy scheme which protects individual privacy without imposing unnecessary burdens on business and the community.[9]

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[6] Ibid., s.46.

[7] Ibid., s.46(3).

[8] There are privacy provisions in some codes of practice in specific sectors (for example, the Telecommunications Industry Ombudsman Code and work by the AUSTEL Privacy Advisory Committee and the Standing Committee of Consumer Affairs Ministers' Working Group on Direct Marketing).

[9] Commonwealth of Australia (1995).

The current Commonwealth government has also indicated that it will 'work with industry and the states to provide a co-regulatory approach to privacy within the private sector'.[10] The format of the government's 'co-regulatory' approach is yet to be determined. However, there has been no suggestion in the announcements of either this or the previous government that a notification or licensing requirement would or should be considered. On the contrary, the general tenor of recent Commonwealth reports and announcements has favoured a flexible approach involving the use of principles and codes of practice.[11] The states and territories have also been considering privacy protection for the public and private sectors.

5.1.4 United Kingdom licensing system

The United Kingdom has taken extensive measures through its *Data Protection Act 1984* to regulate the use, quality and protection of automatically processed information relating to individuals. The legislation is derived from a Council of Europe convention which attempts to balance the freedom to process information with rights to privacy.[12] The legislation creates an independent officer, the *Data Protection Registrar*, whose duties include establishing and maintaining a register of data users and computer bureaux. [13] The register enables individuals to find out, in general terms, who is holding personal data, the classes of data held and what they may be used for. There are criminal penalties for holding personal data when unregistered. The register does not list the names of the individuals about whom information is held but it does describe the main relationship (for example, employee or customer) they have with the holder of the information.

Standards are applied in determining whether or not a particular application for registration should be accepted. An application may be refused if the registrar is satisfied the applicant is likely to contravene any of the Data Protection Principles.[14] These principles broadly resemble the OECD guidelines.

In terms of the definitions in chapter 1, the United Kingdom system satisfies all the requirements of a licensing system (notification, prior approval, standards and compulsion).

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[10] Liberal and National Parties', *Law and Justice Policy*, 23 February 1996.

[11] Advice from Human Rights and Equal Opportunity Commission, Sydney, 15 January 1996.

[12] The Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data (European Treaty Series No.108), opened for signature in 1981.

[13] Within the United Kingdom government, responsibility for policy on data protection matters rests with the Home Office.

[14] An applicant may appeal against refusal to the *Data Protection Tribunal*.

Every data user who holds personal data must, unless all the data are exempt, register with the Data Protection Registrar certain specified details of their processing activities.[15] Thereafter they must operate within their register entry and comply with the set of enforceable *Data Protection Principles* of good practice. Criminal penalties apply for holding personal data when unregistered, when registration is required. In addition, registered data users who knowingly or recklessly hold personal data not described in their register entries commit a criminal offence.

The exemption arrangements appear complex and often depend on business 'intentions' which may be difficult to verify. For example, data used solely to pay wages and pensions or to keep accounts are exempt. Mailing lists of corporate customers kept on computer may contain information about individuals, such as their job title. This information is exempt if it is used solely to ensure that correspondence reaches the correct part of the corporate customer, but if the intention is to communicate with the named individual it is covered by the legislation. The Registrar believes that, in many cases, business mailing lists will prove to be subject to the legislation (UK ODPR 1994, p.22).

The data user must submit a written application to the Registrar. The register entry identifies the data user and provides an address for receiving requests from individuals wishing to access their personal data. The register also describes the personal data held, the purposes for which they are held and to whom the data user may disclose the information, and any overseas country to which the data may be transferred.

Individuals have the right to be told by registered businesses whether or not the businesses hold personal data about them and to be supplied with that data (these are termed *subject access rights*). Businesses may charge a fee, subject to a prescribed maximum of £10, for dealing with subject access (UK ODPR 1994, p.72).

By 24 October 1998 member states of the European Union will be required to implement the EU *General Directive on Data Protection*. This directive sets out to '… protect the fundamental rights and freedoms of natural persons, and in particular their right to privacy, with respect to the processing of personal data'. One of the principal aims of the directive is to harmonise at a high level the different data protection laws in the European Community. There are common features between

[15] A *data user* is defined as a person or organisation controlling the contents and use of a collection of personal data. A *computer bureau* is a person or organisation providing others with services in respect of data. *Personal data* refers to information recorded on a computer about living, identifiable individuals, including statements of fact and expressions of opinion about an individual.

the provision of the directive and those of the UK legislation. For example, registration will remain, though member states may simplify registration and provide exemptions. However, some elements incorporated in the directive are new to the UK legislation, such as the inclusion of some manual records within the scope of data protection legislation.[16]

The advantages of the United Kingdom licensing system over the New Zealand approach are difficult to discern. The United Kingdom system is limited to data held on computer. Because the register does not contain the names of individuals about whom businesses hold information, it can be no more than an aid in searching for those businesses. The benefit of providing opportunities for individuals to have incorrect information amended through subject access rights must be set against:

- the costs imposed on businesses in searching for and supplying data (these costs may exceed the statutory fee, particularly for smaller businesses); and
- the administrative costs of the licensing system.

Moreover, businesses may be less likely to comply with a prescriptive licensing approach than with a code of practice which has been developed consultatively. The United Kingdom licensing system has also been criticised by the Deregulation Task Force as being excessively complex (UK DTF 1995). It recommended the subject access regime be simplified. Likewise, the notification aspect of the latest European Union directive on data protection has also attracted considerable criticism.[17] Licensing systems need to specify the types of information collection, storage and retrieval processes which are being regulated. Consequently, licensing arrangements may lack flexibility and fail to keep pace with developments in information technology.

5.1.5 Other countries

The situation in Canada resembles that in Australia. The federal *Privacy Act 1982* contains a scheme for the public sector (including public enterprises). Only in Quebec does provincial privacy law extend to the private sector. The United States has no general federal statutory privacy law applying to the private sector although there are some specific laws with privacy provisions, and statutory privacy provisions relating to federal agencies.

[16] Advice from UK Data Protection Registrar, 22 January 1996.

[17] Advice from Australian Human Rights and Equal Opportunity Commission, 15 January 1996.

Sweden operates a licensing system involving prior approval of data systems. However, the size of the Swedish *Data Inspection Board* had grown into a substantial bureaucracy by the early 1980s, prompting a reduction in licensing requirements.

5.1.6 Other options

A number of options for regulating the use of private data were canvassed by McBride (1987). Some of these are briefly discussed below.

Create a self-regulating profession of data users

A new self-regulating profession of all those handling personal data by automatic means would avoid the inflexibilities associated with licensing data users and protect data subjects through a binding code of practice. However, the new profession would be difficult to define, would extend beyond computer operators, and would not involve the completion of any clearly defined course of study or evaluation. It would also arbitrarily distinguish between manually- and computer-held data.

Create a general right to privacy

The United Kingdom Committee on Privacy and the Australian Law Reform Commission each concluded that a general right to privacy was not justified because it would be a too uncertain and ill-defined concept. British Columbia and some other provinces in Canada have enacted a statutory tort of privacy but McBride (1987) suggested their experience indicated this was unlikely to provide an effective private remedy to protect information privacy. United States experience with a common law tort of privacy was similarly ineffective as a private remedy to protect privacy. A related option is to amend the law relating to breach of confidence but this law deals only with the disclosure of information, not its collection or security.

Create new criminal offences for breach of information privacy

The United Kingdom *Data Protection Act 1984* creates fifteen separate criminal offences for misusing data. McBride (1987) regarded the role of the criminal law in protecting data privacy as more limited than this, particularly given the need for privacy invasions to be clearly identifiable.

Legislate to allow data subjects to enforce data privacy principles

Under the United States *Privacy Act 1974*, data subjects can enforce privacy principles. However, the legislation is extremely complex, reflecting the need to explicitly provide for the wide range of possible circumstances of different data handling activities.

5.1.7 Assessment

Of the data protection arrangements in use in the jurisdictions examined in this section, the New Zealand approach may provide the most cost-effective and flexible approach. It avoids the compliance and administration costs associated with a licensing scheme such as that used in the United Kingdom. Its consultative nature is likely to encourage compliance and it is capable of accommodating differences in circumstances across industries, professions or businesses.

5.2 Hazardous equipment

Boilers and pressure vessels provide a useful example of the interaction among regulations, standards and codes of practice in different jurisdictions. Comparative regulatory arrangements in Victoria (Australia), New Zealand and the United Kingdom are set out in table 5.1. The arrangements in Victoria are new and those in New Zealand are proposals.

Table 5.1 Primary regulation of the use of pressure vessels

Jurisdiction	*Instrument*
Victoria (Australia)	**Notification** for certain vessels. **Code of practice** to provide practical guidance about compliance (non-compliance is not an offence in itself). **Standards** incorporated in regulations and code of practice.
New Zealand	**Notification** for certain vessels. **Standards** incorporated in regulations.
United Kingdom	**Authorised code of practice** to provide practical guidance about compliance (non-compliance is not an offence in itself). **Standards** incorporated in regulations and approved code of practice.

Sources: Victorian Occupational Health and Safety (Plant) Regulations 1995, SR 81/1995; Victorian Health and Safety Organisation (1995), Code of Practice for Plant; New Zealand Health and Safety in Employment (Pressure Equipment, Cranes and Passenger Ropeways) Regulations (draft); UK HSE (1994).

Notification is necessary in Victoria and New Zealand but not in the United Kingdom. Apart from this difference, the regulatory frameworks for pressure vessels are broadly similar across the three jurisdictions.

The codes of practice in Victoria and the United Kingdom are both voluntary. Failure to observe the code only provides evidence of contravention of the regulations. The user may satisfy the court that the regulation has been complied with in some other way. In the United Kingdom, users need to select technical standards carefully to ensure that they are ‘relevant, current, suitable and adequate’ (UK HSE 1994, p.52) for their intended purpose. Similar considerations apply in Victoria. Under draft regulations proposed in New Zealand, controllers of certain items of plant must notify the authority in writing of the name of the controller and the nature and location of the equipment before operating it. New Zealand standards and requirements for inspection and safety assurance are also set out in the regulations.

In Australia, the recent WorkSafe standard for plant provides a model set of regulations for adoption by Commonwealth and state governments. Unless they are made mandatory by legislation or regulation, standards such as these remain advisory. Victoria has adopted new regulations for plant which are consistent with the common essential requirements of, but are not identical to, the WorkSafe standard.

The new Victorian regulatory structure restricts the hazard identification, assessment and control aspects of the equipment to the designer so that the operator need only use the designer’s specifications and undertake specific site hazard assessments and controls. The new notification system has been described as much less onerous than the system it replaced and inspections and audits by the authority will be reduced (Victorian DBE 1995, p.24).

Notification may impose additional costs on users of hazardous equipment in Australia and New Zealand, compared with the United Kingdom. However, notification may also assist regulatory enforcement by providing a reasonably complete inventory of hazardous equipment as the basis for systematic audits of hazard management systems and procedures. For example, in recent years the Victorian Health and Safety Organisation targeted businesses which had let registrations of ‘high hazard’ boilers lapse.[18]

Whether the Victorian and New Zealand arrangements would be improved by removing notification requirements is an empirical issue. Nevertheless, it is clear that equipment regulation and licensing has been subject to considerable reform and improvement in both jurisdictions in recent years.

[18] Advice from Victorian Health and Safety Organisation, 22 February 1996.

5.3 Food premises licensing

In some jurisdictions, licensing arrangements have been replaced by notification systems. Developments in the licensing of retail food premises, including retail bakeries, provide an interesting example. Among Australian jurisdictions, Queensland, Victoria and the Australian Capital Territory use full licensing systems. Licensing is limited to certain classes of premises in the Northern Territory, Tasmania and Western Australia. New South Wales and South Australia use notification rather than licensing for food premises regulation (ORR 1995a, p.39).

Reasons for replacing licensing with notification in New South Wales were advanced in a report by the Business Deregulation Unit in 1988 (NSW BDU 1988). In particular, the report included arguments that licensing was not necessary to achieve compliance because prosecutions and the issue of orders could restrict the use of premises which contravened food standards just as effectively as the withdrawal of a licence. Notification was still required to provide an information base for authorities to initiate inspections and other enforcement activities including food recall. The inspection system can be funded from premises' registration fees under a *fee-for-inspection* arrangement. In particular, premises which require more remedial attention to comply with the standards may be charged a higher inspection fee.

A notification arrangement (unlike a licensing system) leaves room for an accreditation system to be introduced, is independent of the nature and level of the standards to be enforced and imposes no barriers to entry.

However, the absence of the prior approval required under a licensing system means that sub-standard premises may require expensive renovation costs after their first inspection. Also absent is the scope for using licence renewal as a bargaining tool with which agencies can secure improved compliance with food hygiene standards. Reliance on a notification and fee-for-inspection system may induce authorities to conduct more inspections than the optimal number needed to balance the improvement in public health risk against the cost of enforcement (ORR 1995a, p.40).

5.4 Summary

In this chapter, situations in which codes of practice and standards may be more appropriate means of regulation than licensing for certain commercial activities, as well as cases in which notification may be preferred to licensing are discussed.

Notification systems enable regulatory authorities to better target their inspection and enforcement activities, but involve costs for both businesses and authorities. Standards and codes of practice are capable of providing businesses with guidance and flexibility. Whether licensing or notification is also required depends on whether the identity of the business is important and whether prior approval is expected to be cost-effective.

Whilst the format of the government's 'co-regulatory' approach is yet to be determined, it would seem unlikely that Australia would adopt the unwieldy licensing system imposed on business users of personal data in the United Kingdom. Early statements by the current government have focused on any Australian regime being comparable with international best practice.[19]

Licensing is not used for regulating hazardous equipment in any of the jurisdictions examined. Australian arrangements rely on a combination of notification, minimum mandatory standards imposed though regulation, and codes of practice to provide practical guidance. The overseas jurisdictions examined appear broadly similar, except that the United Kingdom does not use notification. The authorities may find it worthwhile to test whether notification is justified on benefit-cost grounds.

Licensing has been replaced by notification and fee-for-inspection arrangements in regulating food premises in some Australian jurisdictions. Some enforcement incentives may be lost by abandoning licensing, although prosecutions and orders may be an adequate substitute.

[19] Liberal and National Parties', *Law and Justice Policy*, 23 February 1996.

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6 Compulsory contracts

Some potential market failures are addressed by compelling businesses to obtain certain services for the firm or for its employees. An example is a compulsory contractual arrangement to purchase workers' compensation insurance from one of a number of authorised insurers.

This chapter focuses on the comparative administrative flexibility available to employers in these arrangements. It examines workers' compensation and social security arrangements, including unemployment benefits and the funding of retirement incomes. Four administrative situations are described:

- Employers are required to notify a public monopoly supplier. Because the service is provided by a single agency this arrangement is termed a *notification* in accordance with the definitions in chapter 1.
- Employers are required to enter a contract with one of a number of authorised service providers. This requires the employer to enter a *compulsory contract* which may provide greater choice or flexibility than a notification to a public monopoly.
- Businesses may be allowed to provide the service internally subject to satisfying various criteria (for example, self-insurance for workers' compensation).
- There may be no requirement for employer involvement at all.

Some economic issues involved in these arrangements are discussed in section 6.1. Workers' compensation arrangements are examined in section 6.2, and social security systems are the subject of section 6.3.

6.1 Economic issues

Regulation of monopoly insurers may encourage implicit subsidies, taxes or cross subsidies. It is difficult to distinguish some compulsory insurance arrangements with monopoly government insurers from tax and subsidy arrangements or from generally provided social security. The Australian Medicare levy, for example,

covers approximately half of the benefits paid under Medicare and a smaller fraction of the total cost to government of the social provision of medical services. In the United Kingdom less than two-thirds of social security outlays are financed by earmarked taxes, such as the *National Insurance Contributions* (NICs) discussed below, and by employer and employee pension contributions.[1]

Implicit or hidden subsidy arrangements are less likely when a firm has a choice of alternative private sector suppliers. Explicit subsidies (or taxes) are, however, possible when there is a choice of private suppliers, for example, where the government legislates to subsidise or tax either the premiums or the benefits of the private sector insurance suppliers.

Cross subsidisation is also possible where there are private providers. Community rating for private medical insurance is an example. Private medical insurers in Australia are not permitted to charge premiums that differ by age. The result is a cross subsidy from young and healthy customers as a class to the elderly as a class.

Where government is the monopoly provider of insurance the level of implicit subsidy may be difficult to determine and the distributional effects can be complex. Medicare involves absolute subsidies (as the aggregate benefits exceed the Medicare levy) and large cross subsidies between the healthy and not so healthy. In many countries social security taxes and entitlement programs involve large subsidies on both a cash flow and an actuarial basis.[2]

Notifications and compulsory contracts may or may not involve taxation and transfer arrangements. These arrangements have implications for the economic welfare of the community at large but their consideration is beyond the scope of this study. Instead, this report focuses on the flexibility of administrative arrangements from the viewpoint of businesses and employers.

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[1] In Australia in 1994–95, Medicare benefits amounted to $5.7 billion (Health Insurance Commission, *Annual Report 1994–95*, p.84) while the Medicare levy raised an estimated $3.0 billion (Commonwealth *Budget Statements 1995–96*, p.4–25). In the United Kingdom in 1993–94, social security outlays amounted to £117.7 billion, compared with NICs of £42.6 billion, employer pension contributions of £21.7 billion and employee pension contributions of £10.6 billion (Hills 1995, p.31).

[2] It is possible to have a positive cash flow social security arrangement containing a large subsidy when calculated on an actuarial basis. For example, where there is a large population approaching but not yet of retirement age a social security/tax system would require a large positive cash flow to accumulate sufficient reserves to provide retirement incomes for the current generation.

6.2 Workers' compensation insurance

In the absence of mandatory workers' compensation insurance arrangements, many employees would probably demand these services from private insurers either individually or through a trade union. This does not mean that the cost would or should be borne by employees: part of the cost could be passed on to employers through compensatory wage claims.

Similarly, it is misleading to regard the cost of workers' compensation insurance as being borne entirely by employers because it may be passed on to consumers (and workers) through higher output prices and backward to employees in the form of reduced wages or employment levels.

To some extent, compulsion in the provision of industrial insurance addresses the external costs of workplace accidents and disease by forcing employers to include these costs when making safety decisions.[3] However, workers' compensation insurance schemes may generate important externalities themselves. For example, some employees have been found to use the social security system to compensate for the cost of workplace injury or illness rather than using workers' compensation insurance (Industry Commission 1994a, pp.169–171).

Therefore, it is important to consider the social security system in conjunction with workers' compensation insurance schemes. In some countries, such as Japan, extensive social insurance systems involve employers in both social welfare and workers' compensation insurance.

Provision of workers' compensation insurance is not sufficient to ensure employers have adequate incentives to provide safe workplaces.[4] As a result, other instruments, in addition to the compulsory contracts and notifications used for workers' compensation insurance, are often applied to workplace safety. Some of these involve direct regulation of hazardous equipment, for example, and were discussed in chapter 5.

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[3] Not all external effects can be dealt with by workers' compensation because 'higher compensation benefits and broader eligibility may increase the incentive for fraudulent claims and may also delay the injured employee's return to work' (Industry Commission 1995a, v.1, p.180).

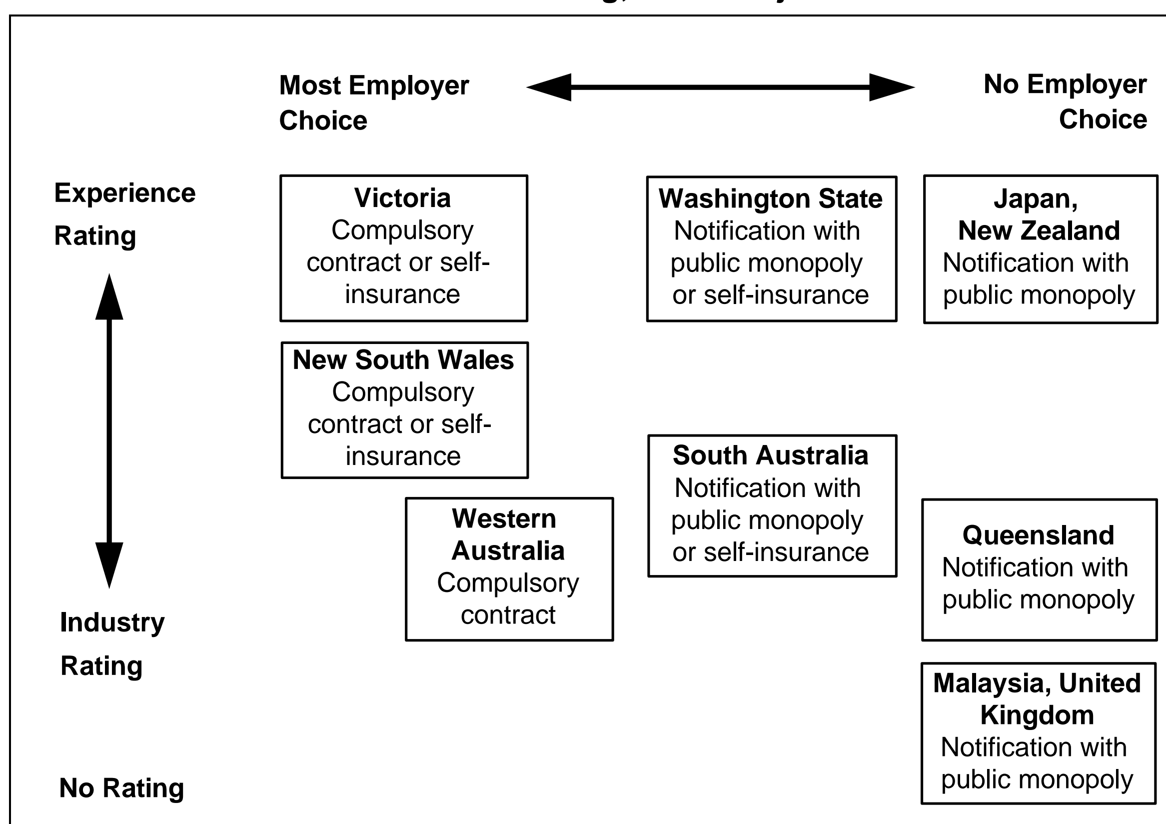
[4] These incentives are discussed below in connection with the use of*experience rating.*

6.2.1 Employee workplace insurance

A limited comparison of workers' compensation insurance arrangements in terms of their administrative arrangements in a number of countries is made in figure 6.1. The criteria for assessing the effectiveness of the instrument used in each country are:

- the extent to which employers are able to choose how to handle workers' compensation liability (measured along the horizontal axis); and
- the extent to which there is an incentive for individual businesses to influence their direct insurance costs by adopting safety measures and systems (measured along the vertical axis).

Figure 6.1 Employee workplace insurance instruments by employer choice and nature of rating, selected jurisdictions[a]



a *Industry rating* is the practice of setting insurance premiums on an industry basis. *Experience rating* adjusts the premiums for the firm's recent claims experience.

Sources: Industry Commission (1994a); Malaysian Social Security Organisation (1992), *Employment Injury Insurance Scheme and Invalidity Pension Scheme*, Kuala Lumpur.

These criteria are not used to make overall assessments of the efficiency and effectiveness of the workers' compensation schemes in each jurisdiction. There are obviously many more issues involved in comparing workers' compensation insurance schemes than employer choice and the nature of the rating scheme. A comprehensive analysis of workers' compensation schemes in Australia is contained in Industry Commission (1994a).

Other things being equal, instruments which offer employers the maximum choice and the greatest incentive to provide a safer workplace environment are assumed to be generally superior. These are located in the top left hand corner of the table. Conversely, the least desirable instruments are those which involve no choice for employers and less incentive to improve the safety characteristics of workplaces. However, it should be noted that the table presents only two dimensions of the design of workers' compensation insurance schemes. It omits many other important aspects. For example, schemes which provide greater incentives may also involve higher administrative costs. Therefore, it cannot be used alone assess the efficiency and effectiveness of schemes in the jurisdictions shown.

Systems which allow larger employers to self-insure or to choose among different insurers provide greater choice than those which involve notification with a single public monopoly fund. Systems which adjust workers' compensation premiums for individual firms on the basis of their claims experience (*experience rating*) are likely to provide stronger workplace safety incentives than those which base premiums on the general experience of the industry of which the firm is a member (*industry rating*).

However, the Industry Commission (1994a) found that industry rating was more appropriate for small firms because of the difficulty in inferring the degree of risk from the relatively small numbers of claims made by smaller firms. Experience was regarded by the Industry Commission as a better indicator of risk for larger firms. In practice, even under experience rating less weight is usually given to small businesses' claims experience when determining premiums and so small firms are effectively industry rated. Critics of experience rating argue that it may encourage non-reporting of workplace injury or illness.

Instruments used to provide for workers' compensation insurance in Australia compare favourably with those in the overseas locations surveyed on the basis of the criteria used in figure 6.1. It is important to again stress that these comparisons do not involve all of the features of the relevant workers' compensation schemes but merely the nature of some of the important administrative arrangements as they affect businesses.

- Victoria and New South Wales appear to use better instruments than the other jurisdictions examined in the table on the basis of the scope for choice and the rating scheme used. In both states, workers' compensation must be provided through compulsory contracts with licensed private insurers, with scope for self-insurance for larger firms. Full experience rating has been introduced in Victoria, with partial experience rating in New South Wales.

- South Australia uses a degree of experience rating through a bonus and penalty system of adjustments to premiums (Industry Commission 1994a, p.B12).

- Western Australia and Queensland use industry rating in setting workers' compensation premiums. However, Western Australia offers more choice through compulsory contracts with private insurers. Queensland uses a public monopoly fund without scope for self-insurance.

Japan, New Zealand and Washington State all use experience rating. Japan and New Zealand require the use of a public monopoly fund but Washington State allows self-insurance for large corporations. In these jurisdictions, the instrument amounts to a notification rather than a compulsory contract.

- In Washington State applications for workers' compensation insurance can be made when obtaining a Master Business License (see the companion volume, *Business licences — International benchmarking*).

- In New Zealand, the public fund is operated by the Accident Rehabilitation and Compensation Insurance Corporation (ACC) which is supplied with information about new employers from their taxation registration with the Inland Revenue Department (IRD). The ACC then contacts employers to advise them of their obligations. The IRD also acts as a premium collection agency for the ACC.

- In Malaysia, insurance can only be obtained through a public monopoly. Moreover, premiums are not based on either the industry in which the business is engaged or the claims experience of the business. Instead, premium rates are uniform for all businesses.

In the United Kingdom, workers' compensation is largely handled through the general social security system (specifically, the *Industrial Injuries Scheme*). Benefits from this scheme are usually payable after the end of *statutory sick pay* (see sub-section 6.2.2). Except for work accidents, some NICs must have been paid before an employee is entitled to benefits. Employers may supplement the benefits available to employees by taking out a policy with an authorised insurer (Industry

Commission 1994a, pp.E28–9). In these cases, the choice of rating system is left to individual insurers and premiums are not regulated.

6.2.2 Employee non-work medical and accident insurance

In some jurisdictions, employers are required to become involved in the provision of medical or accident insurance for employees other than in the workplace.

Japan, Malaysia, the United Kingdom and the United States all require employer contributions to employee medical or accident insurance.

- In Japan, virtually all businesses must provide employee health insurance, with cover extending to defined dependants. Where the number of insured employees exceeds 700, private health insurance societies can be formed by an individual corporation or by groups of employers acting jointly. Government health insurance is available to smaller firms. The self-employed and employers are covered by the separate *National Health Insurance* scheme.

- In Malaysia, the Social Security Organisation manages the workers' compensation fund. It also has an employee-contribution scheme covering employees for invalidity or death from any cause.[5]

- In the United Kingdom, employers are responsible for paying employees statutory sick pay for up to 28 weeks' absence in any one period of sickness. Payments of statutory sick pay are treated as employee earnings for the purposes of calculating NICs and are treated as part of the general notification requirements for NICs.

- In the United States, the *Federal Insurance Contributions Act* requires employers and employees to make contributions for aged, survivors', disability and hospital insurance in the form of social security and Medicare taxes.

Australia and New Zealand do not directly require employers to contribute to medical or accident insurance for their employees.

These comparisons are summarised in table 6.1.

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[5] Employees with relatively high commencing salaries need not join the fund but, should they choose to do so, they will remain covered regardless of future changes in their salary. Membership is compulsory for all other workers.

Table 6.1 Comparative employee non-work insurance arrangements, selected jurisdictions

Jurisdiction	*Regulatory instrument involving employers*
Australia	**No employer involvement:** compulsory medical insurance with a public monopoly fund
Japan	**Notification:** compulsory medical insurance with a public or private fund
Malaysia	**Notification:** compulsory invalidity pension scheme with a public monopoly fund
New Zealand	**No employer involvement:** compulsory accident insurance with a public monopoly fund
United Kingdom	**Notification:** compulsory statutory sick pay (covered by PAYE taxation registration with Inland Revenue)
United States (Washington State)	**Notification:** compulsory medical insurance with a public monopoly fund (covered by employer identification number with Internal Revenue Service)

Sources: Japan Social Insurance Agency (1994), Malaysian Social Security Organisation (1992), *Employment Injury Insurance Scheme and Invalidity Pension Scheme,* Kuala Lumpur; Invest in Britain Bureau, *Labour costs and wages data sheet*; United Kingdom Contributions Agency 1995, *National Insurance Contributions Manual for Employers*, CA28(NI269); United States Internal Revenue Service, *Employment Taxes*, Publication 937.

6.3 Social security

The choice of social security regime depends heavily on the social and cultural values of the local community. However, differences in the types of instruments used internationally are instructive. Moreover, some arrangements may provide employers and employees with greater flexibility in providing for income security needs than others.

6.3.1 Unemployment assistance and insurance

Unemployment benefits (known as *Job Search* and *Newstart allowances*) in Australia are paid from general taxation revenue. There are no insurance or contributory fund arrangements and no direct financial contribution by employers.

The Australian arrangements may more properly be characterised as unemployment assistance than unemployment insurance, providing a safety net for the unemployed through a basic level of income support while maintaining incentives for individuals to re-enter the workforce. Benefits are targeted to those in need of assistance, taking into account family size, other income and available assets. The incentive to rejoin the workforce is reinforced by testing whether unemployment benefit recipients are actively seeking work and by providing access to retraining programs.

This contrasts with the Japanese *Employment Insurance System* which requires contributions from employers. Unemployment benefits depend on employees' period of insurance, their age and any special factors making employment difficult. Benefits are also related to wages during the six months prior to the job loss. Unemployment insurance schemes such as these focus on income maintenance.

Arrangements in the United States more closely resemble those in Japan than Australia. The US *Federal Unemployment Tax Act* (FUTA*)* and state unemployment insurance arrangements provide for payments of unemployment compensation to workers who have lost their jobs. State unemployment insurance payments by employers are deducted (up to a maximum limit) when determining the size of FUTA payments. Washington State unemployment insurance contributions depend on the employer's experience with unemployment claims, the rate paid by the previous business owner and the average rate for the industry.

Table 6.2 Comparative unemployment insurance arrangements, selected jurisdictions

Jurisdiction	*Regulatory instrument involving employer*
Australia	None
Japan	**Notification:** compulsory employment insurance
Malaysia	None
New Zealand	None
United Kingdom	**Notification:** compulsory national insurance fund (covered by PAYE taxation registration with Inland Revenue)
United States (Washington State)	**Notification:** federal unemployment tax (covered by employer identification number with Internal Revenue Service); compulsory state unemployment insurance (endorsement under Master License)

Sources: Japan Social Insurance Agency (1994); Invest in Britain Bureau, *Labour costs and wages data sheet*; United Kingdom Contributions Agency 1995, *National Insurance Contributions for employees 1995-1996*; United States Internal Revenue Service (1995), *Circular E, Employer's Tax Guide*, Publication 15; Washington State DoLic (1995).

In the United Kingdom, unemployment benefits, like other social security benefits, are handled as part of the NICs. An unemployment beneficiary must have actually paid NICs on qualifying earnings over a specified period.

As can be seen in table 6.2, Australia, Malaysia and New Zealand place no direct burden on employers to provide unemployment insurance, whereas Japan and the United States operate systems with extensive employer involvement. On the other hand, general taxation levels may be higher in Australia to the extent that employers in Japan and the United States finance these areas of social security.

6.3.2 Retirement pensions

Australia, Japan and the United Kingdom use compulsory contracts to provide workers with retirement pensions.

- In Australia, provision for retirement income involves a combination of public and private arrangements. A means-tested age pension is paid from general taxation revenue. Under the *Superannuation Guarantee* employers are required to make prescribed minimum contributions to complying superannuation funds on behalf of their employees or otherwise pay a tax.

- New Zealand provides a government-funded, means-tested age pension as part of the social security system. There is no direct employer involvement.

- Japan offers aged pensions under two compulsory public schemes. The *National Pension* provides a basic pension and the *Employees' Pension* provides additional earnings-related benefits. In addition, firms may set up *Voluntary Employers' Pension Funds* if they have more than 500 workers.

- In the United Kingdom, retirement and other social security benefits are handled through NICs. A *Basic Retirement Pension* is payable if NICs were made in respect of an employee's income in any year since 1975. This may be supplemented by an *Additional Pension* (AP) under the S*tate Earnings-Related Pension Scheme* if NICs have been paid on earnings exceeding a specified minimum. However, employers can choose to use their own approved pension scheme (a *contracted-out employers' occupational pension scheme*) and benefits payable from a contracted-out scheme will be deducted from any AP benefits.

Notifications are used in Malaysia, which operates a compulsory public pension fund, and in the United States, where the *Federal Insurance Contributions Act* also requires employers and employees to make contributions for aged, survivors' and disability insurance.

The relevant comparisons are made in table 6.3.

Table 6.3 Comparative retirement pension insurance arrangements, selected jurisdictions

Jurisdiction	*Regulatory instrument involving employer*
Australia	**Compulsory contract:** compulsory private pension fund and public pension
Japan	**Compulsory contract:** public or private pension fund
Malaysia	**Notification:** compulsory public pension fund
New Zealand	No employer involvement
Singapore	**Notification:** compulsory public pension fund
United Kingdom	**Compulsory contract:** public or private pension fund
United States	**Notification:** compulsory public pension fund

Only the extent of employer involvement is shown. There may also be other safety net schemes to provide retirement income which do not involve employers and which are not shown. For example, the government-funded means-tested age pension in Australia.

Sources: R. Willis (1995), 'Saving for Our Future', Statement by the Commonwealth Treasurer; Japan Social Insurance Agency (1994); Malaysian Industrial Development Authority (1994), *Guidelines on licences and approvals in the manufacturing sector*; New Zealand Income Support Service (1995), New Zealand Superannuation — a general guide; United States Internal Revenue Service (1994), *Employment taxes*, Publication 937; V.W. FitzGerald (1993), *National Saving: A Report to the Treasurer*.

Overall, the Australian approach of using compulsory contracts with private pension funds may provide greater flexibility for employees than do the public monopoly pension funds used in Japan and Malaysia. By promoting competition in the provision of retirement income security, and provided adequate safeguards are in place, it may also encourage greater efficiency on the part of the private funds compared with the activities of a public monopoly.

6.4 Summary

Compulsory contracts provide greater administrative flexibility to businesses than do notification systems which compel them to deal with public monopolies in such areas as workers' compensation and social security arrangements.

Employers are required to provide workers' compensation insurance in all of the jurisdictions surveyed. Some Australian jurisdictions require employers to enter into compulsory contracts with authorised insurers, while others offer this service solely through a public monopoly. Few of the overseas jurisdictions surveyed offer the level of flexibility available in some Australian jurisdictions. In contrast to their counterparts in some other countries, Australian employers have no administrative involvement in providing non-work employee accident insurance.

Unlike employers in some other countries, Australian employers also have little involvement in the provision of unemployment insurance. In Australia, retirement pensions are provided partly by compulsory contract. This represents a more flexible arrangement that the notification systems used in some of the other jurisdictions surveyed.

This overview should be treated with caution because it puts to one side a number of important economic issues associated with workers' compensation and social security, including the extent to which these arrangements are subsidised by taxpayers. However, it indicates that Australian employers have access to at least as wide a range of choices in providing these services as do employees in the overseas jurisdictions examined.

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7 Licences and the regulatory context

Licensing is part of a larger regulatory environment. In this chapter, a number of general regulatory developments relating to licensing are discussed. As regulation reform proceeds, the role of licensing can be expected to change accordingly.

In section 7.1, the concept of *regulatory flexibility* is introduced. This provides a basis for the examination of the use of voluntary agreements in section 7.2. Voluntary agreements are becoming an increasingly important adjunct to licensing systems in a number of areas. The growth of voluntary compliance arrangements which overlay existing regulatory structures is documented in section 7.3, with a particular focus on the chemical industry's *Responsible Care* program.

In the companion volume, *Business licences — International benchmarking*, master licensing and integrated approval systems are examined as potential mechanisms for improving the design of licensing systems. These systems involve rationalising the number of applications needed to obtain a given number of licences. A complementary strategy involves rationalisation of the numbers of licences needed by businesses. This involves determining whether or not licences currently in use are necessary and whether alternative regulatory instruments might be equally effective while imposing less cost on business. Licence rationalisation is discussed in section 7.4.

7.1 Regulatory flexibility

In its broadest sense, regulatory flexibility encompasses a range of techniques designed to achieve regulatory objectives in a more efficient (less costly) way for the community at large. These techniques attempt to overcome the deficiencies of traditional command and control regulation — deficiencies such as slow responsiveness to innovation, failure to reflect substantial differences in the circumstances of individual businesses, and excessively complex and prescriptive rules.

An example of regulatory flexibility is the proposal by Ayres and Braithwaite (1994, p.106) of a negotiated rule-making process. Under such a process each business would write its own rules, reflecting its unique circumstances. These would be ratified by a regulatory agency (or returned to the firm for revision if they were not stringent enough). Enforcement would be the responsibility of an inspectorate employed by the firm but independent of its management. Government auditors would safeguard the independence and efficiency of the inspectorate. Violations of the rules would be punishable by law.

Advantages claimed for this approach include simpler rules which would have specific application to businesses, which could be adapted more quickly to changing circumstances, and to which firms would be more committed. Businesses would bear more of the cost of their own regulation. Ayres and Braithwaite also suggest that their approach would avoid the conflicts inherent in trying to comply with both corporate and official regulations, and the conflicts between different government agencies.[1]

However, a number of problems have been identified with this approach, including:

- the cost to the regulators of approving many firm-specific rules (although the reduction in compliance costs may more than offset this);
- small businesses may lack the expertise to write and enforce their own rules;
- businesses may experience delays in obtaining approval of rules;
- firms may attempt to write their regulations in ways which would help them defeat the intent of the law; and
- the independence of the corporate inspectorate could not be guaranteed.

In Canada, many elements of the negotiated rule-making approach are being applied to federal regulation. The *Canadian Railway Safety Act 1989* enables railways to write their own safety rules under specific conditions. These include federal approval and stakeholder consultation. A commission of inquiry found that railway safety had not been compromised by this development and that the new procedure was a less expensive approach to regulation.[2]

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[1] Of course, conflicts could persist if more than one regulatory agency is involved in the ratification process.

[2] Report of the Railway Safety Committee 1994, ‘On Track: The Future of Railway Safety in Canada’, Canada Communications Group, Ottawa.

More generally, the proposed Canadian *Regulatory Efficiency Act* represents a major application of the regulatory flexibility model (see the appendix for a fuller discussion). It would allow regulated businesses to submit compliance plans specifying alternative means of achieving regulatory goals. These compliance methods may not normally be permitted under existing regulations. Applicants would need to demonstrate publicly that the alternative compliance plans fully meet or exceed existing regulatory objectives.

Other businesses can submit proposals to become subject to the same plan. The responsible minister is required to monitor the implementation of the plan and can terminate it if the original objectives of the regulation are compromised. Breach of a compliance plan is punishable in the same way as a breach of the regulation itself.[3]

Merit exemptions are another example of the application of regulatory flexibility. Businesses which have in place systems designed to ensure compliance with regulations, and which have a proven history of best practice performance may be exempted from some regulatory requirements. An example of such a scheme is the Victorian accredited licensee scheme used by that state's Environment Protection Authority and described in the companion volume to this report (*Business licences — International benchmarking*).

Gunningham (1995) has proposed a similar approach to regulation in the chemical industry. Statutory *general duties* (for example, to use the best practicable means to limit pollution) and *performance standards* (for example, goals to be achieved) would set minimum environmental targets for chemical firms. Non-mandatory *codes of practice* would provide practical guidance about how to comply with the general duties and performance standards. Businesses could join a regulatory scheme under which they would be free to choose other compliance methods, provided these were at least as effective as the codes of practice. Government agencies would audit the results of the self-monitoring of businesses participating in this regulatory scheme. Firms which refused to join the scheme would still be required to comply with the targets but would be directly regulated in the conventional way.

7.2 Voluntary agreements

Voluntary agreements between businesses and regulatory authorities, in practice, fall well short of the regulatory flexibility model. However, elements of that approach are present in some existing agreements. For example, bargaining between

[3] The New South Wales government is exploring the use of mechanisms similar to the Canadian approach.

planning authorities and the owners of land proposed for development is possible in both the United Kingdom and Victoria (Australia). The Altona Chemical Complex best practice agreement attempts to provide a much less prescriptive regulatory environment to a selected group of chemical manufacturers than is available to similar firms elsewhere in Victoria. Another example is the option given to industries at Kwinana in Western Australia to propose their own set of emission limits for use by the regulator.

7.2.1 Planning agreements

Land use zoning laws, which specify the particular uses to which land may be put within each zone, have been criticised as overly prescriptive. The use of outcome-oriented planning regulation as an alternative to traditional zoning is discussed in chapter 8 of this report's companion volume, *Business licences — International benchmarking*.

Some critics have suggested that another means of enhancing the flexibility of planning systems is to allow bargaining between developers and planning authorities (as representatives of the broader community). In this application of property rights, the enhanced value of the land to the developer may allow a payment to be made to the community representative which reflects any social cost imposed on the community by the development (Ogus 1994, p.242). The 'payment' may take the form of ensuring that the development meets certain performance objectives, or be a contribution to infrastructure costs necessitated by the development.

Planning agreements are used in Victoria as a way of making it easier to achieve planning objectives for a particular locality or parcel of land than is possible by relying on other statutory mechanisms. An agreement is a legal contract between the responsible authority and the owner of the land. It requires the owner to carry out any matters specified in the agreement. Planning agreements may provide for the prohibition, restriction or regulation of the use of the land. They may set out the conditions subject to which the land may be used or provide for any matter intended to advance planning objectives.

Although agreements provide an alternative means of achieving planning goals, they are not intended to be a substitute for planning controls. Agreements are not intended to be used if an authority's aims can be adequately met through permit conditions or if an amendment to a planning scheme is more appropriate (Victorian DoPD 1994).

Planning agreements can bind the owner (not only the developer) and allow positive covenants which enable performance criteria to be included in the title to the land. This provides planning authorities with a wider range of options to achieve the types of development they want. Agreements can be registered on a title to be made binding on future owners. To the land owner's benefit, agreements can also create positive obligations for the responsible authority. The main disadvantage of planning agreements is that a good agreement requires legal advice and so can be costly and time-consuming. Also, problems can arise if the provisions of the agreement become too complicated (Victorian DoPD 1994).

The Building Owners' and Managers' Association argues the need for reforming legislation governing planning agreements in all Australian jurisdictions (BOMA and BDW 1995, p.15). In particular, it argues that legislation is needed to prevent a consent authority unreasonably refusing to amend an agreement and that there should be provision for the regular review of agreements so that they remain relevant to planning regulation.

In the United Kingdom, formal agreements between developers and authorities also attach to the land and bind future owners. However, they have attracted controversy because they escape the normal appeal procedures (Ogus 1994, p.242).

7.2.2 Altona Chemical Complex regulatory agreement (Melbourne)

In August 1994 the Victorian Minister for Industry and Employment signed a *best practice regulation agreement* between the Victorian Government and the five companies forming the Altona Chemical Complex in Melbourne.[4] It represents the replacement of traditional licences and other regulatory instruments for health, safety and environment (HSE) management with a contractual HSE *operating agreement* between each company and regulators. Eventually, these HSE agreements are to be administered through a fully coordinated *Best Practice Industry Authority* with access to government and industry resources.

Each agreement includes a set of *core principles.* Under these the Victorian Government agrees to use best practice regulatory principles in exchange for the companies' commitment to implement performance-based industrial health, safety and environment (HSE) management systems. It requires national and state standards to be aligned, an integrated approvals process for new projects, the management of overlap between regulatory systems, open communication channels between the government and the complex, and community consultation.

[4] The complex comprises the adjacent operations of BASF Australia Ltd, Dow Chemical (Australia) Ltd, Auseon Ltd, Hoechst Australia Ltd and Kemcor Australia Pty Ltd.

The importance of community consultation is emphasised in a report on best practice chemical regulation commissioned by the Victorian Department of Business and Employment (Victorian DBE 1995). The report noted that the low public image of the chemicals and petroleum industry causes the industry uncertainty about its longer term tenure. It recommended the recognition of the public as a stakeholder to create an environment for proactive regulation and management. The Altona Community Neighbourhood Consultative Group, chaired by local government, has been monitoring the complex's HSE performance since 1989. It provides input to each company's environmental improvement plan and circulates a newsletter to all residents.[5]

An action plan directed towards continuous improvement of the complex's performance in the areas of occupational health and safety and environmental management also forms part of the agreement. It requires regulatory authorities to develop processes which recognise performance-based company systems. It provides for a trial of monthly meetings between the government and the complex to coordinate project approvals, and six-monthly meetings between heads of regulatory authorities and complex chief executive officers to review planning. The use of an integrated project application is also being trialed.

Outcomes achieved to date include a HSE performance-based management framework agreed between the government and the complex, an evaluation of international trends in HSE regulation and enhanced channels of communication between government agencies and industry (ACC 1995). The management framework agreement includes HSE quality management requirements, performance indicators for public and government reporting and operating guidelines for matters such as risk assessment and project approvals.

The companies are now seeking to adopt an integrated operating agreement with the relevant Victorian government regulatory agencies. Underpinning this agreement is a set of HSE quality management protocols agreed between agencies and companies. These are derived from the chemical industry *Responsible Care* codes of practice (see section 7.3).

The steps involved in negotiating the agreement are illustrated in figure 7.1. It is anticipated the agreement will be trialed at the Altona Chemical Complex in 1996.

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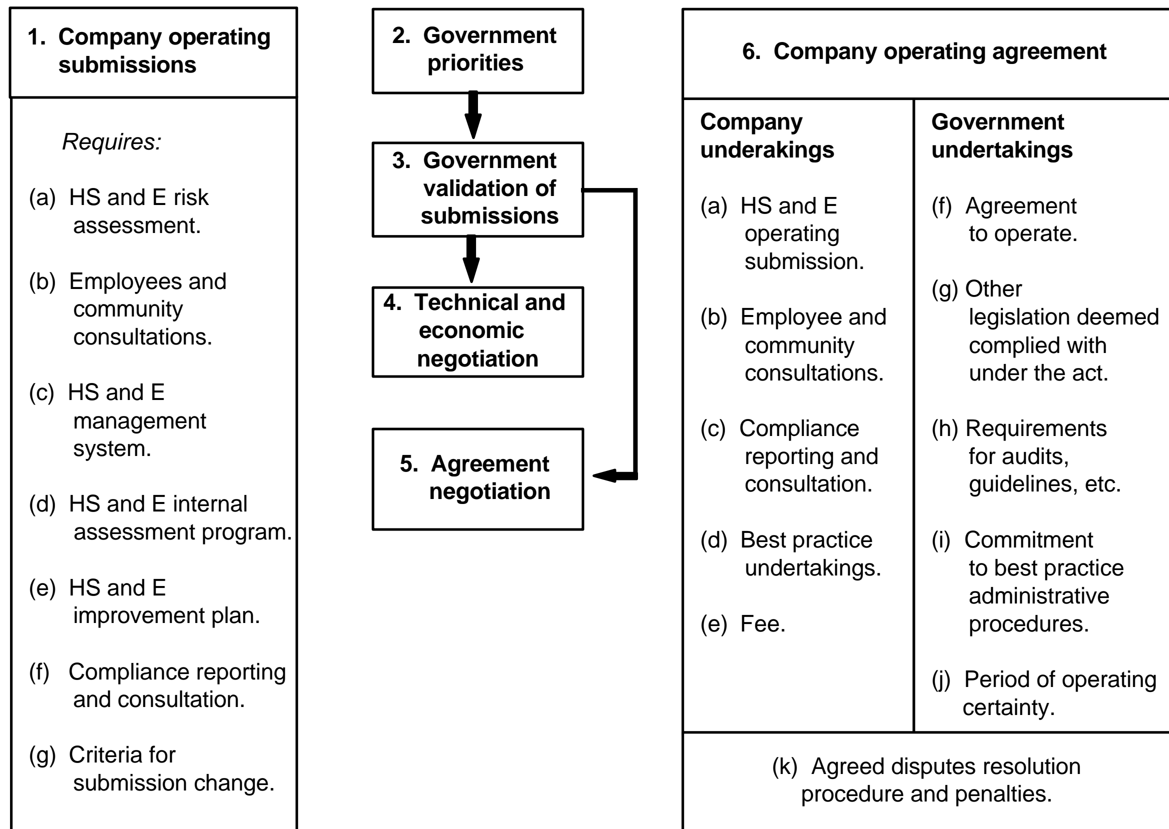
[5] Community resistance to the industry was previously so strong at Altona that all planning applications were opposed, including one for a bicycle shed (Victorian DBE 1995, p.55).

Figure 7.1 Altona health, safety and environment agreement system



Data source: ACC 1995.

7.2.3 Industry-proposed emission limits: Kwinana ai rshed

An agreement covering sulphur dioxide emissions in the Kwinana industrial area of Western Australia was negotiated between the WA Department of Environmental Protection (DEP) and Kwinana Industries Council representing the business community. The Environmental Protection Policy developed by the DEP for the area sets ambient concentration standards for sulphur dioxide. Under this policy, the chief executive officer of the DEP is given considerable flexibility in determining how emission limits for individual sources are to be determined.

Affected firms proposed a set of emission limits for each significant source. These were verified by a simulation model of the airshed as meeting the ambient ground level standards. Limits take the form of fixed rates or may vary according to specified conditions.

The emission limits are enforced through discharge licences. Industries monitor both their own discharges and the ambient concentrations of sulphur dioxide at key locations. Instances in which the ambient standards are exceeded are investigated to

determine whether the emission limits need to be redetermined and to enable the predictive ability of the airshed model to be improved. Unlike the tradeable quota systems of the United States, property rights in reductions in emission limits are not recognised and the air above the industrial area is considered to be a state resource. This means that resumptions of emission limits by the government, or improvements in the efficiency of abatement technology may be needed if new sources are to be admitted into the airshed.

Tradeable quotas have not been used because of the small number of potential traders and the difficulties involved in defining a single total emission cap (Rayner 1995, p.7).

7.3 Voluntary compliance

Regulators, businesses, industry associations and concerned communities can develop procedures designed to encourage best practice in such areas as health, safety and environment (HSE) which extend beyond the minimum requirements of traditional regulation. Two examples are discussed below: the chemical industry's *Responsible Care* program and the concept of *cleaner production technology*.

7.3.1 Responsible Care

The *Responsible Care* program described in box 7.1 provides an example of the response of industry to the need for performance improvement in areas subject to traditional command and control regulation. Through the Plastics and Chemicals Industries Association (PACIA)[6] Australia, in 1989, became the third country in the world to introduce the program.

In Australia, Responsible Care has developed eight codes of practice containing 270 management practices. These define the performance standards and complement existing regulatory requirements. They cover the community's 'right to know'; research and development; manufacturing; emergency response and community awareness; waste management; warehousing and storage; transportation; and product stewardship. The codes for waste management, manufacturing and emergency response have been accepted by the Victorian Environment Protection Authority and the Victorian Health and Safety Organisation as best practice environmental management systems. The New South Wales Environment Protection Authority has also accepted parts of the waste management code for use

[6] Then known as the Australian Chemical Industry Council.

by polyelectrolyte suppliers.[7] While the codes specify target performance levels, the means of achieving those targets are chosen by the companies and based on their own circumstances.

The product stewardship code applies standards to businesses using chemicals supplied by PACIA members. In this way, the program's effects potentially extend beyond its member firms (Victorian DBE 1995, p.54). The program also includes an independent National Community Advisory Panel comprising people with community, environmental, emergency service and scientific backgrounds.

Compliance with the codes is self-assessed by the companies and reported to PACIA. Self-assessment is supplemented by external verification by Standards Australia, Lloyds Register or the National Association of Testing Authorities. Each site has one code externally verified every two years.

In Canada, Responsible Care has been important in reducing the prescriptiveness of regulation. For example, Responsible Care provided the basis of a scheme for the voluntary reporting of emissions by chemical companies (the *National Emission Reduction Masterplan*). This, in turn, was the template for the Canadian government's *National Pollutants Release Inventory*. It has been argued that the Canadian approach has avoided many of the bureaucratic requirements imposed on United States chemical companies under that country's *Toxic Release Inventory* (Victorian DBE 1995).

Concerns have been expressed about compliance with the program in the United Kingdom. For example, evidence quoted by Welford (1995) indicates that only 57 per cent of program firms in the United Kingdom made returns to the association in each of three consecutive years and only 74 per cent made any returns at all. Smith (1994) examined plant operators' applications for licences under new United Kingdom mandatory controls. Many of the plant operators were committed to Responsible Care, yet 23 per cent of applicants provided no environmental assessment of air emissions and pollution inspectors had to ask around half the operators to do more monitoring.

[7] Plastic and Chemical Industries Association, *Responsible Care News*, January 1996. Environmental management systems are discussed in chapter 8 of the companion volume, *Business licences — International benchmarking*. The *AgSafe* system applies HSE standards to the supply of agricultural and veterinary chemicals but, unlike Responsible Care, can apply commercial sanctions against non–complying businesses with the backing of exemption from the *Trade Practices Act* (Victorian DBE 1995, p.54).

Box 7.1 Responsible Care

The *Responsible Care* program is a performance improvement program which involves the establishment of closer links between the community and chemical companies. It originated in the Canadian Chemical Producers' Association in 1984 and has been adapted in other countries, including Australia and the United Kingdom.

The *abiding principles* for Responsible Care in Australia are:

- recognising and responding to community concerns about chemicals and chemical production;
- operating facilities so that the environment is preserved and the health and safety of the public and employees are protected;
- producing chemicals which can be manufactured, transported, used and disposed of safely;
- giving priority to health, safety and environmental considerations in planning new products and processes;
- reporting hazards promptly to authorities, employees, customers and the public and recommending protective measures;
- advising customers on the safe use, transport and disposal of chemical products;
- conducting or supporting research on the health, safety and environmental effects of chemical products, processes and wastes;
- cooperating with customers, authorities and affected groups and individuals to resolve problems created by handling and disposing of hazardous chemicals;
- cooperating with government to develop regulations based on scientific data or expert opinion to safeguard the community, workplace and environment; and
- sharing experience and assisting other chemical producers and users.

Source: Information supplied by Plastics and Chemical Industries Association.

However, Australian evidence indicates that compliance rates with the various Responsible Care codes of practice in Australia have been progressively rising since the start of the program.[8]

Responsible Care has been characterised as being important to firms having an integrated HSE program for chemicals involving preventative management strategies for hazards (Victorian DBE 1995, pp.46–7). It is being used as one of the

[8] Plastic and Chemical Industries Association, *Responsible Care News*, January 1996.

inputs to the development of best practice HSE agreements at the Altona Chemical Complex (see sub-section 7.2.2).

7.3.2 Cleaner Production Technology[9]

Cleaner Production is a comprehensive, preventative approach to environmental protection and achieving business cost savings. It involves businesses reviewing all phases of manufacturing processes and product life cycles to determine where changes can be made to reduce environmental impact. Production is assessed from design, through manufacturing, to end-product use, repair, reuse, recycling and disposal measures in factories, offices and homes.

Cleaner Production strategies are focused on saving energy, water and raw materials as well as on eliminating toxic substances and reducing the amount of wastes. It goes further than ‘end-of-pipe’ solutions which can prove costly and provide only short-term alleviation of environmental problems. It focuses on redesigning processes further up the production stream to avoid the creation of pollution and waste and save on inputs. It takes a broad view of the whole of product life and disposal.

The Commonwealth, through its Environment Protection Agency, is working with a variety of organisations, including industry groups, unions, consulting and research organisations, state government environment departments and local governments, to demonstrate that Cleaner Production can be beneficial for business and the environment. This work includes a national demonstration project, a database showing the use of Cleaner Production in a variety of businesses, and various pilot projects involving local government working directly with business. Information about best practice in the environmental management of mining, developed in a cooperative project with the Australian mining industry, has been published and is being expanded.

The Victorian and South Australian Environment Protection Authorities help small- to medium-sized businesses undertake demonstration projects to promote Cleaner Production. The Australian Centre for Cleaner Production, established by the Victorian Environment Protection Authority in conjunction with industry, promotes and provides training in Cleaner Production throughout Australia and the Asia-Pacific region.

[9] Much of the following information about Cleaner Production was provided by the Commonwealth Environment Protection Agency.

In the United Kingdom, chemical, metal manufacturing, textile, food processing, electronics and paper and printing companies have been adopting cleaner technologies (UK JEMU).

There may be commercial incentives for business to implement Cleaner Production Technology. These may take the form of efficiency gains which justify the initial costs of the cleaner technology. There may also be commercially favourable public perceptions from using Cleaner Production.

7.4 Licence rationalisation

The companion volume to this report, *Business licences — International benchmarking*, includes a discussion of master licensing systems and integrated approval systems designed to reduce the numbers of applications and renewals needed for a given set of licences. Regulators have also been attempting the reduce the numbers of licences. This section describes some of these licence rationalisation programs in Australia. Proposals for removing unnecessary licences in the United Kingdom are discussed in section 3.5.

7.4.1 New South Wales Licence Reduction Program

The New South Wales government recently introduced a *Licence Reduction Program* to reduce the regulatory burden on businesses, especially small business. The program aims to eliminate unnecessary or inappropriate business licences and streamline requirements where licences are genuinely needed. There are, for example, several hundred building trades licences currently administered by the New South Wales Building Services Corporation, many of which may be unnecessary (Refshauge 1995).

The program complements other regulatory review programs by examining licences which have not been comprehensively reviewed before, or where duplication or overlap is not easily resolved by a simple review. In more complex cases it may be necessary to re-engineer the regulatory system of which the relevant licences form part. Some solutions may involve *composite licences* which incorporate the essential elements of existing licences. Where licences cannot be removed, compliance costs are to be reduced — for example, by extending the duration of licences so that renewal is needed less frequently.

Agencies administering licences are required to complete a check list which tests whether or not:

- government intervention is needed;
- all the alternatives to licensing have been identified; and
- the burden of licensing is being minimised.

The checklist includes tests for the effects of licensing on competition, small business compliance costs and costs to consumers and government as well as for the extent of any benefits of licensing.

7.4.2 Victorian Licence Simplification Program

In February 1995 the Victorian Cabinet endorsed a *Licence Simplification Program,* including a review process, to benchmark Victoria's licence requirements against those of other Australian jurisdictions and to consider alternatives to licensing for achieving the underlying objectives of a licence. By the end of 1995, licence types had been reduced by 26 per cent.

7.5 Summary

Licensing reform is part of the larger process of regulatory reform and improvement which gained momentum in many countries during the 1980s. That improvement process has seen the emergence of innovative approaches to regulation designed to reduce costs without sacrificing the attainment of justifiable regulatory objectives. It has included the spread of regulatory flexibility principles, including greater use of negotiated rule-making between business and regulators, as well as agreements which exchange greater regulatory flexibility for improved outcomes for business.

Regulators in Australia are increasingly recognising the value of providing incentives for good performance by industry in such fields as environmental and health and safety management. These incentives usually include less prescriptive regulation (as in the Victorian EPA accredited licensee system or the Altona Chemical Complex agreement). Increased regulatory flexibility in Australia carries many potential benefits for businesses and the community at large. It is not yet as widespread or advanced as that being pursued by Canadian federal regulatory agencies.

In many countries, industry has proposed voluntary measures which overlay the existing regulatory framework and which are designed to generate improved regulatory outcomes for the community and the businesses concerned. There has been a strong movement in Canada to endorse voluntary initiatives to address externalities and information failures. Similar approaches are emerging in Australia.

As in a number of other countries, there have been pressures in Australia to justify the need for licences and to seek alternatives capable of providing greater net benefits to society. It will be important for the economic welfare of Australians that this momentum for improvement be maintained.

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8 Implications for Australia

Regulation need not rely solely on business licensing. There are many alternative regulatory instruments which can achieve the same objectives for the community and impose less cost on businesses. These include accreditation schemes, negative licensing, standards, codes of practice and compulsory contracts. It is also possible to improve existing licensing arrangements through increased regulatory flexibility. This can include increasing the scope for businesses to negotiate rules and regulations, the use of regulatory agreements, and reliance on voluntary initiatives by industry superimposed on the existing licensing or regulatory framework. Finally, licences may be rationalised without prejudicing the ability of the regulatory framework to achieve its objectives.

Section 8.1 contains a summary of the options available for rectifying the anticompetitive effects of licensing in the context of the Hilmer reforms. In section 8.2, the scope for using standards and codes of practice in place of licensing is examined. Compulsory contracts as alternatives to notification systems are discussed in section 8.3. Section 8.4 contains a discussion of the implications of regulatory flexibility for licensing in Australia.

8.1 Restrictions on entry

Licensing, especially when exercised by industry or professional associations (*co-regulation*), may lead to anticompetitive behaviour — for example, through manipulation of entry requirements. Where this occurs, consumers and new businesses will be disadvantaged by prices higher than those which would prevail under more competitive conditions. The expectation of these higher prices will be reflected in the value of existing licences, creating incentives for licensees to resist reforms designed to benefit consumers. Such restrictions operate like an invisible tax on consumers, transferring income and wealth to licensees.

There may be other problems with co-regulation, including the potential for abuse when the same body represents the profession, writes the rules of conduct and enforces those rules.

The Australian Competition Principles Agreement provides for a review of anticompetitive regulatory arrangements by Commonwealth, state and territory governments by 2000. Restrictions on entry, imposed under occupational licensing arrangements, are relevant to this review.

Barriers to entry under licensing can be addressed in a number of ways:

- Co-regulating agencies may be replaced by independent government licensing agencies. However, the advantages of co-regulation, such as the superior auditing and inspection capabilities of professional associations, are likely to be lost.
- Co-regulating agencies may be required to become registered with an independent body on condition that the registered agencies do not permit anticompetitive behaviour by their members. Such a system has been proposed for lawyers in Victoria, Australia.
- Licensing of professions may be replaced by licensing of actions taken by professionals which may give rise to harm or externalities. This reduces the number of activities which are potentially subject to entry restriction, including those which are not harmful or do not generate spillovers. This approach has been adopted for pharmacy licensing in Ontario, Canada, in a coregulatory environment.
- Negative licensing, which does not restrict entry but involves ex post prohibition of businesses failing to meet quality standards, is another option. Real estate sub-agents in Victoria, Australia, are regulated using negative licensing.
- Licensing may be replaced by voluntary accreditation systems which address the public's need for information about the quality of the service provided without restricting entry to potential suppliers. This would also seem to require the removal of general prohibitions on advertising by professionals. Product liability law may also have a role as an alternative to licensing. Licence rationalisation programs are being pursued in a number of Australian jurisdictions and in the United Kingdom.

The specific reform approach adopted should reflect the ultimate objective of securing the highest positive net benefits for the community.

8.2 Standards and codes of practice

In some circumstances, minimum standards and codes of practice may be sufficient to achieve regulatory objectives without the additional requirement for licensing or notification. The regulation of the private sector's use of personal data is a good example. Some countries, such as the United Kingdom, have required businesses to notify an independent registrar about their use of personal data. Others, such as New Zealand, have favoured a more flexible, and less costly, system which outlaws abuses of personal privacy and which allows businesses to develop codes of practice tailored to their own circumstances. Australia appears likely to follow the New Zealand approach.

Licensing may be replaced by notification systems, under which prior approval is unnecessary but standards continue to be enforced. For example, in Victoria (Australia) and New Zealand, the use of hazardous equipment simply requires notification and the satisfactory assessment of site-specific hazards by the user. Provided the equipment is of an approved design, prior inspection and approval are not necessary. In the United Kingdom, even notification has been dispensed with. In New South Wales, health premises licensing has been replaced by a notification system, with inspection occurring after notification. Fees are based on the extent of the health risk presented by the premises.

Optional prescriptive codes of practice may be useful for businesses lacking the resources to develop and implement their own codes and standards. This may be particularly so for small business. This issue is discussed in more detail in the companion volume to this report, *Business licences — International benchmarking*.

8.3 Compulsory contracts

Just as notifications may be preferred to licences, compulsory contracts may, in some circumstances, be superior to notifications. Notifications are used in many jurisdictions where employers are required to provide or contribute to such services such as workers' compensation insurance, unemployment insurance and retirement pension schemes. These notifications usually arise because the service is provided by a monopoly (usually government-owned) supplier. Employers would have greater choice and flexibility in providing these services if they were required to enter a compulsory contract with one of a number of authorised suppliers.

Employers are involved in these arrangements more heavily in many overseas jurisdictions than in Australia. When Australian employers are required to provide these services, they are increasingly able to do so using compulsory contracts.

8.4 Regulatory flexibility

Licensing has been evolving within the broader context of regulation reform, both in Australia and overseas. The increasing flexibility of regulatory arrangements is relevant to licensing in a number of respects.

The scope for alternatives to licensing appears relatively limited in the cases of planning and building approval. This was recognised in the companion volume to this report, *Business licences — International benchmarking*, which addressed some specific design issues for these licensing systems, including integrating the approval process and reducing the prescriptiveness of standards. In this volume, the importance of regulatory flexibility has been highlighted in the form of opportunities for negotiation between developers and planning authorities about the terms and conditions of a prospective development.

More generally, the potential for negotiated rule-making to improve regulatory outcomes is being increasingly recognised by Australian agencies. The Altona Chemical Complex best practice regulatory agreement in Victoria, Australia, is an instructive example. This agreement co-exists with and augments various licensing arrangements at the affected sites. However, of the jurisdictions surveyed, perhaps Canada is the most advanced in disseminating and applying regulatory flexibility principles.

Finally, the importance of licensing also depends on the overall regulatory context within which it is used. This includes the extent to which businesses are encouraged to exercise controls over product quality and over environmental impacts in excess of those specified by minimum standards.

8.5 Summary

Accreditation schemes, negative licensing, standards, codes of practice and compulsory contracts are all potential alternatives to licensing and notification which may be able to deliver greater positive net benefits. However, improving existing regulatory arrangements is no simple matter, as the examples presented in this volume make clear.

It may be desirable to retain licensing but to change its regulatory focus (for example, licensing actions rather than occupations). Another option is to reform the regulatory environment within which the licensing system operates (for example, by reducing the risk of abuse by co-regulating industry or professional associations).

Moreover, the companion volume to this report, *Business licences — International benchmarking*, sets out a checklist of best practice criteria for the design of licensing systems.

Reducing anticompetitive behaviour is not the sole reason why licensing and notification systems should be monitored and reviewed. More efficient and effective approval and licensing systems can benefit Australia's competitiveness and welfare in much the same way as improvements in infrastructure services. In both cases, continuous improvement will be needed to maintain and improve the performance of Australian regulators.

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Appendix Regulatory reform in Australia and overseas

This appendix provides a brief sketch of regulatory developments internationally. Different countries have chosen to reform their regulatory environment in a variety of ways reflecting their individual legal, social and cultural circumstances. Moreover, although all of the countries discussed below have moved in the direction of reform, the pace of reform has varied and they have begun from different starting points.

A.1 Australia

The Commonwealth, state and territory, and local governments have all been engaged in regulatory reviews and improvement programs relevant to business licensing for some years.

Reform in Australia has been proceeding across a wide range of regulatory environments relevant to business. The following list of examples of reform is not exhaustive.

- The Local Approvals Review Program has been trying to improve local government land use approval systems.
- The Australian Building Codes Board has developed the Building Code of Australia which promotes national uniformity in building standards. More recently it has been developing a more flexible performance-based building code.
- Greater national uniformity in Australian occupational health and safety (OH&S) regulation has been sought through a taskforce set up by the National Occupational Health and Safety Commission.
- The Commonwealth, states and territories have legislated for national uniformity in food hygiene regulation and the National Food Authority has been developing national food hygiene legislation. A treaty between Australia

and New Zealand to establish a joint standard-setting process was signed in December 1995.

- Legislation has been passed to establish the National Environment Protection Council which is intended to help develop uniform national environmental standards. These include measures, goals, guidelines and protocols concerning ambient air and water quality, wastes, site contamination, motor vehicle emissions, noise and recycling.

A.2 Organisation for Economic Co-operation and Development

The OECD's Public Management Committee, through the Public Management Service, has been disseminating information about regulatory reform among OECD nations. In conjunction with the European Community and other organisations, it has also been promoting the development of efficient public institutions in the former communist states of Europe (SIGMA 1994).

A.3 European Commission

The European Commission has introduced measures requiring the economic evaluation of any new regulations likely to be particularly burdensome on business. As well, product testing standards and regulation in the EC became more flexible during the 1980s. Most recently in Europe, the Molitor expert group provided general proposals to the commission for simplifying regulation and administration in a number of key areas (EC 1995). A number of recent European Community initiatives have addressed excessive regulation.

A.3.1 Fiche d'impact

In June 1986, the European Commission introduced a business impact assessment system (*fiche d'impact*) for legislative proposals by the commission to the Council of Ministers. Since 1991 only those legislative proposals having a significant impact on business through the economic effects of compliance have been targeted but the assessment system's scope was extended to include legislative acts of the commission itself (EC 1992, pp. 40-46).

There appears to be little attempt to quantify the economic consequences of a proposal and is often little more than a vague, *ex post* rationalisation of the measure.[1] An example is the assessment for a proposal for a council directive on the protection of the physical and psychological well-being of young people at work. With respect to the economic effects of the proposal, the assessment contains no estimate of its effect on employment, investment, the creation of new businesses or the competitive position of business. Instead, there are vague assertions such as:[2]

> The proposal does not seek to impose a ban on the employment of young people on the labour market, but simply to prevent abuse in the way young people's labour is utilised. More particularly, the point is to respect measures taken by the Member States on vocational training for young people. … Firms should themselves benefit from a higher level of safety and health protection for young people. After all, good stewardship of human resources is vital to business success.

A.3.2 New approach and conformance assessment

Conformance assessment is the process of determining 'whether or not a product or system meets a required standard' (Kean Report 1995, p.105) and includes product and quality systems certification and laboratory testing. Since the 1980s the European Community has adopted a *new approach* which restricts regulation to the essential safety requirements for large groups of products or risks.

A.3.3 Molitor review

In September 1994, the European Commission established a group of independent experts to make proposals to alleviate and simplify EC and national legislation, taking into account economic and social considerations. The group's report (EC 1995), covering machine standards, food hygiene, the environment and social legislation, contains general proposals about simplifying regulation and administrative procedures across the EC and at a national level. It identified biotechnology, taxation, public procurement, construction products, consumer protection, company law, commercial policy, energy, common agricultural policy, fisheries, banks, statistics, competition policy, transport, telecommunications and social security as additional areas of concern.

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1 Ogus, personal communication, 9 February 1996.

2 Impact Assessment Form: The Impact of the Proposal on Business with Special Reference to Small and Medium-Sized Enterprises (SMEs) — Proposal for a Council Directive on the protection of young people at work, 27 November 1991.

A.4 United Kingdom

Considerable deregulation activity has occurred in the United Kingdom in recent years. The *Deregulation Initiative*, together with the *Citizen's Charter*, represent the major recent elements of the UK government's regulatory reform program. Procedures for developing regulations for use by central government agencies now include mandatory *compliance cost assessments* and recommended *risk assessments*. Proposals for new regulation must now be assessed by the departments proposing them in the context of the compliance burden imposed on industry.

A.4.1 The Deregulation Initiative

In 1993 the United Kingdom government set up seven sectoral deregulation task forces, following a recommendation by Lord Sainsbury (the government's then adviser on deregulation), to identify the main areas of excessive regulation adversely affecting growth and efficiency in each sector. The task forces included representatives of small business because it was claimed that these suffer the most from over-regulation.

In their report on proposals for reform (UK DTFs 1994), the task forces endorsed three principles of good regulation:

- *think small* (ensure small firms can cope with the regulation);
- the *proportionate regulation test* (the cost of regulation to be proportional to the benefits obtained); and
- *goal-based regulation*.

At the same time as the task forces deliberated, the *Deregulation and Contracting Out Act 1994* was prepared. This provided Ministers with the power to order the amendment or repeal of legislation imposing a burden on business subject to the important proviso that 'necessary protection' should not be removed. A new, single deregulation task force was announced in January 1994 to continue the original work and the key recommendations of its latest report (UK DTF 1995) include:

- a complete review of all remaining business licensing requirements with a view to abolition within two years;
- a single information point where new and growing businesses can find out details of licensing and notification requirements, and a single notification for all tax purposes; and

- the new Environment Agency fulfilling its potential as a one-stop service for business.

A.4.2 Citizen's Charter

The *Citizen's Charter* provides a range of mechanisms and ideas designed to improve the quality of public service. It sets out six principles which should apply to all public services covering the publication of standards and information about the cost and quality of the service, choice and consultation, courtesy, dispute resolution and giving value for money (UK DoE 1994). The principles are reinforced by more detailed charters for individual services such as for patients, parents, jobseekers, tenants and developers.

A.4.3 Compliance cost assessments

UK government departments are required to compile *compliance cost assessments* (CCAs) for every proposed regulation that could affect business (UK PM 1994). The CCA is intended to inform Ministers and officials of the likely costs to business of complying with new or amended regulations. It will then be possible to assess compliance costs and identify unnecessary burdens to business before a decision is taken to proceed.

In describing the implementation of CCAs, the UK government has commented that the 'burdens on business of EC legislation are more complex and difficult to control than those on domestic legislation' (UK PM 1994, p.10). It regards the EC *fiche d'impact* as no substitute for a CCA focused on the UK compliance costs. The CCA is important as part of the UK lobbying effort with the EC in connection with proposed regulation.

Risk assessments

Government departments should provide Ministers with a risk assessment to assist them in reaching a decision on any new regulatory proposals affecting business. Ministers will be required to personally sign off each risk assessment and satisfy themselves that the regulation strikes an appropriate balance between costs and benefits.

A.5 United States

Successive federal administrations in the United States have sought to reduce the compliance costs associated with regulation. At present, there are requirements on federal agencies to analyse the effects of new regulations on small business and procedures to review the paperwork burden imposed by federal agencies. The most recent US federal initiative in this area is the National Performance Review.

A.5.1 Small business: the Regulatory Flexibility Act 1980

The *Regulatory Flexibility Act 1980* (RFA) requires federal agencies to identify those proposed regulations that might significantly affect a substantial number of small businesses[3]. The agency must examine the number of small businesses in the regulated community, the number that will be affected by the regulation and the monetary impact of the regulation on them. Agencies must publish agendas listing such regulations and prepare *regulatory flexibility analyses* of their effects (Schoenberg 1995).

Most importantly, the RFA requires that an agency describe significant alternatives to the proposal that achieve the agency's objectives but minimise the impact on small business. These alternatives may include performance rather than design standards and exemptions of small businesses from all or part of the rule (US SBA 1994). In contrast, the United Kingdom Deregulation Task Force recommended the removal of regulatory exemptions, barriers and thresholds so that essential regulation is applied universally.

Monitoring the compliance of agencies with the RFA is the responsibility of the Chief Counsel for Advocacy of the Small Business Administration (SBA). The RFA recognises that federal agencies often overlook the effects of their rules on small business and that small entities are disproportionately disadvantaged by federal regulation.

> … if the costs of compliance are fixed, the smaller entity will suffer more severely because it has a smaller output over which to recover the costs … This translates directly into raising the smaller firm's marginal cost of production and reducing its ability to set competitive prices, expand and create jobs, devise innovations or … continue as a viable organization. (US SBA 1994, pp.3–4)

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[3] In fact, it is the effect of regulation on small 'entities,' including small government jurisdictions such as cities and towns, which is relevant (Schoenberg 1995).

The Chief Counsel has been critical of many facets of the operation of the RFA. For example, in practice, the ability of the Internal Revenue Service to denominate its rules as interpretive means that many taxation requirements affecting small employers are outside the scope of the RFA. 'Boilerplate' certifications that a rule will not have a significant economic impact on a substantial number of small entities are used by many agencies in place of explanations of the certification decision. Agencies may fail to examine a wide variety of options or limit the number of discrete alternatives examined. This may lead to the omission of entire approaches to reducing regulatory burdens (US SBA 1994).

These limitations have led business to complain that the RFA as 'has no real teeth'.[4] The National Performance Review recommendations concerning the RFA are discussed below.

A.5.2 Paperwork Reduction Acts of 1980 and 1995

The *Paperwork Reduction Act of 1980* (PRA) reinforced the review authority of the Office of Management and Budget (OMB) over federal agency information collection powers. Amendments in 1986 created the OIRA within OMB with the objectives of, *inter alia*:

- minimising the federal paperwork burden on the public, small businesses and state and local governments; and
- minimising the federal cost of collecting and using information and maximising its usefulness.

The OIRA reviews federal agency requests for approval of forms, surveys and other information collections. It works with other federal agencies and the public to improve collection methods, coordinate policies and reduce duplication and unnecessary requirements (US OMB 1993).

While much of the activity of the OIRA is directed towards general data reporting requirements, some of it is directly relevant to business licensing. These include the approval of forms through which the public supplies information to comply with federal law, including tax forms and customs declarations. The powers of OIRA were severely limited by a recent Supreme Court decision which held that the PRA applies only to records maintained by employers or provided to the government and not those provided by employers to a third party (US CSB 1994, p.74).

[4] National Small Business United, National Association of Women Business Owners and Arthur Andersen & Co, '1994 Small Business Issue Priorities', Washington D.C. and Chicago.

Since 1988 federal agencies must print on each form, survey or other information collection their estimate of the average time or burden that a respondent would incur in providing the information. Agencies must also ask for comments on the burden estimate, or on any other aspect of the collection. Since 1988 the OMB has received over 4 000 public comments on federal forms (US OMB 1993, p.17). Examples of paperwork burden estimates for Internal Revenue Service forms are shown in table A.1.

Table A.1 US Internal Revenue Service estimates of paperwork burden

Form	*Purpose*	*Record keeping*	*Learning about the law or the form*	*Preparing and sending the form to the IRS*
940	Employer's annual federal unemployment (FUTA) tax return	11 hrs., 43 min.	18 min.	30 min.
941	Employer's quarterly federal tax return	11 hrs., 43 min.	28 min.	1 hr., 53 min.
W-2	Wage and tax statement	n.a.	n.a.	32 min.

Source: Relevant IRS forms.

The *Paperwork Reduction Act of 1995* requires agencies to obtain public comment on proposed information collections before submission to the OMB for approval. Agencies are also required to obtain approval for requirements forcing disclosure of information to third parties or the public (Schoenberg 1995).

A.5.3 National Performance Review

The *National Performance Review* (US NPR 1993) made a number of recommendations to improve federal regulatory efficiency:

- the use of market-oriented and 'other innovative' approaches to regulation whenever appropriate;
- agency representatives working with affected interests in a cooperative effort to develop regulations, as well as using focus groups, public hearings and other tools to involve those affected by regulations;
- streamlining internal rulemaking processes, including 'direct final' rulemaking to reduce the time needed to implement non-controversial regulations; and
- focusing regulatory resources on more serious environmental, health and safety risks.

The review recommended that agency compliance with the RFA be subject to judicial review and that the Office of Advocacy be authorised to draft government-wide guidance on compliance with the RFA.

A.5.4 Federal Executive Orders

The Reagan administration introduced a centralised review process for existing regulations, under the authority of the OMB, to ensure that regulations imposed the least net costs to society.[5] New regulatory actions were required to satisfy a benefit-cost test as well. Agencies were also required to consult with OMB about their plans for significant rules from their inception.[6]

Following the National Performance Review, President Clinton signed a new executive order dealing with regulatory planning and review.[7] It established a *Regulatory Working Group* to provide a forum to help agencies identify and analyse important regulatory issues. The group is convened by OIRA and comprises the heads of each agency having significant regulatory responsibility (US OIRA 1994a).

The centralised regulatory review powers of OIRA were restricted to significant regulatory actions only.[8] This is intended to lead to a more effective allocation of OIRA's resources. This means that OIRA now reviews less than half the number of rules that it did before the new executive order (US OIRA 1994b).

Finally, the *Unfunded Mandates Reform Act of 1995* contains further requirements for agencies to assess the effects of federal regulatory actions on the private sector, as well as on state, local and tribal governments. It also requires the OMB to report annually to Congress on agency compliance with the act (Schoenberg 1995).

A.6 Canada

The Canadian government broadened its regulatory review processes in the early 1990s into a system wide approach covering compliance, competitiveness and training of regulators (Industry Commission 1995d). Federal regulatory reform is

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[5] Executive Order 12291, issued by President Reagan in February 1981.

[6] Executive Order 12498, issued by President Reagan in January 1985.

[7] Executive Order 12866, issued by President Clinton in September 1993.

[8] The Order defines a 'significant' regulatory action as those likely to lead to a rule having an annual effect on the economy of at least US$100 million, or adversely and materially affecting a sector of the economy, or creating a serious inconsistency with an action of another agency, or materially changing the budgetary impact of transfer payments, or raising novel legal or policy issues (US OIRA 1994a).

the responsibility of the Regulatory Affairs Division (RAD) of the Treasury Board Secretariat.

A.6.1 The Treasury Board Regulatory Policy

In February 1992, the Treasury Board adopted a *Regulatory Policy* which is a formal, legally binding directive on all federal regulatory authorities. These authorities are required to show that existing and proposed regulations satisfy conditions which include that (Martin 1995):

- they address a problem or risk, government intervention is justified, and regulation is the best alternative;
- adequate public consultation has occurred;
- the net benefits of regulation are positive and maximised;
- the impact on national competitiveness is minimised;
- compliance and enforcement policies are articulated; and
- adequate enforcement resources are available.

Agency performance is monitored by RAD, which examines proposals for new regulations and can escalate issues to federal cabinet if necessary.

A.6.2 Regulatory Management Standards

Standards for regulatory management, based on the ISO 9000 standards, are expected to augment the *Regulatory Policy* in late 1995. These are designed to require the major regulating departments to initiate their own internal regulatory review processes. The key requirements of the draft *Regulatory Management Standards*, in addition to those set out in the *Regulatory Policy*, are (Martin 1995):

- Consultations must be conducted with affected parties about alternative (non-regulatory) solutions and analysis should be undertaken to assess the proposal's effect on businesses. In particular, the impact on small business should not be disproportionate.
- The regulatory program should include program objectives, program delivery specifications and delivery control procedures.

- There must be clear processes for affected parties to provide feedback on any regulatory proposal.
- New regulations and changes to existing regulations must be well publicised and easily accessible to affected parties.
- Regulations must be written in plain language.
- Regulatory personnel must be trained to carry out the requirements of the policy.

A.6.3 Regulatory Efficiency Act

The proposed *Regulatory Efficiency Act* (REA) would allow regulated businesses to submit compliance plans specifying alternative means of achieving regulatory goals. These compliance methods may not normally be permitted under the existing regulations. Applicants would need to demonstrate publicly that the alternative compliance plans fully meet or exceed existing regulatory objectives. Ministers have no flexibility to change the relevant regulatory objectives and any ministerial decisions must follow the principles of sustainable development and not jeopardise health or safety.

The REA bill was introduced on December 1994 and, following consultations with members of parliament and stakeholders, a series of modifications have been proposed. The REA is now to operate as follows:[9]

- A minister and the President of the Treasury Board would jointly seek cabinet approval to designate specific regulations for which discretionary powers could be used. The REA will only apply to regulations that prescribe technologies, product or process standards of a technical nature, or that are administrative or procedural in nature. Following a consultative process, cabinet would advise the Governor in Council to issue an order designating the specific regulations as being subject to the REA.
- After consulting with interested parties and governments, the relevant existing regulatory authority would then publish design criteria and procedures for approving compliance plans.

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[9] The following is based on information supplied by the Treasury Board of Canada, including an explanatory memorandum of proposed changes as at 17 November 1995.

- A business could then propose a compliance plan to the authority which would publish the proposed plan and consult with interested parties before approving the application. Approval would only be granted if the business could demonstrate, on the basis of factual information and convincing evidence, that the proposal would be at least as effective in attaining the regulatory goals as the regulation itself would have been.

- An approved compliance plan would be automatically referred to the appropriate standing committee of the House of Commons to determine compliance with respect to the achievement of regulatory goals. The committee would have the power to put forward motions of disallowance in the House of Commons.

Other businesses could submit proposals to become subject to the same plan. The responsible minister would be required to monitor the implementation of the plan and could terminate it if the original objectives of the regulation were compromised. Breach of a compliance plan would be punished in the same way as a breach of the regulation itself.

A.7 New Zealand

New Zealand has undertaken an extensive program of economic change in recent years. The introduction of a goods and services tax, combined with the enactment of new and complex legislation (such as the *Resource Management Act 1991* and the *Health and Safety in Employment Act 1992*) and changes to industrial relations arrangements led to concerns about the level of compliance costs faced by business.

The New Zealand government set up a Business Compliance Cost Reduction Working Group in April 1994. It is chaired by the Ministry of Commerce and comprises 17 agencies whose activities impose compliance burdens on business. Compliance cost reduction work has been coordinated by a steering group comprising the Ministry of Commerce, the Inland Revenue Department, Statistics New Zealand, the Treasury and the New Zealand Employers' Federation.

The key elements of the compliance cost reduction program are (NZ MoF 1994):

- a set of departmental action plans designed to reduce compliance costs;

- incorporation of action plans into departmental accountability documents;

- continuing consultation with business;

- the development of techniques for measuring compliance costs;
- the adoption of compliance cost assessment along United Kingdom lines;
- increased public dissemination of obligations under government regulations; and
- the development of methods of reducing third party compliance costs (for example, obligations on employers and banks to provide information about employees and customers).

Working group consultations with industry associations and businesses indicated that compliance costs were particularly onerous for small firms.

New Zealand has introduced compliance cost assessment along the lines of the UK model. All cabinet papers proposing new regulation require a compliance cost statement and, if the costs imposed on business are significant, an assessment will be required. Departments are required to consult with affected businesses to determine the impact of the proposed legislation.

A.8 Japan

Japanese statutes have been described as very general, providing considerable discretion to the government bureaucracies administering them. Japanese bureaucracies also make extensive use of administrative guidance involving informal advice and encouragement of parties to comply with government policy (Sly and Weigall 1995).

Japanese action to reform its regulatory framework is relatively recent compared with the United Kingdom, United States and Canada. It has been stimulated by concern that excessive regulation constrained the recovery from the severe (by Japanese standards) recession of the early 1990s and United States pressure for trade policy reform. It has become a key part of the Japan–US Structural Impediment Initiative Talks (Industry Commission 1995d, p.97).

A five-year regulatory review program was adopted in March 1995, and is focused on (Japan ARPH 1994):

- reconsidering regulations controlling market entry (including licences, entry by foreign firms and exemptions from the *Anti-Monopoly Act* for cartels);
- clarifying approval processes, data requirements and standards for licences, including the publication of standard processing times;

- examining the possibility of measuring red tape burdens with a view to abolishing certain notifications, reducing the frequency of reporting and automating record keeping;
- minimising price regulations;
- in-principle promotion of mutual recognition and international standards of conformance assessment; and
- engaging in public consultation about the deregulation process.

A.9 Malaysia

The *New Economic Policy* (NEP), introduced in 1971, has been described as having the

> … ultimate aim of achieving national unity through poverty eradication irrespective of race and inter-ethnic economic parity through a 'restructuring' exercise. (Gomez 1994, p.3)

Its principal objectives were to redistribute income and wealth in favour of native Malay and other indigenous communities (collectively, *bumiputera*[10]). In 1970, foreign ownership of limited liability companies exceeded 60 per cent and the Chinese community owned over 20 per cent. Malay and Indian ownership was less than 2 per cent. The NEP initially sought to increase bumiputera ownership and establish a stronger Malay business community. The government assured the Chinese community that redistribution under the NEP would occur within the context of a growing economy.

What followed was a period of greater regulation and control of economic activity. Bumiputera trust agencies were established to acquire corporate assets for the community and new public enterprises were formed. Government enterprises were active in acquiring foreign entities. The *Industrial Coordination Act 1975* increased government controls over manufacturing businesses.

By the early 1980s many public enterprises had begun to incur large losses. In response, privatised projects began to appear as early as 1983 and sales of existing public enterprises began in 1985. At the time of the implementation of the *Industrial Master Plan* in 1986 (see below), equity guidelines for the manufacturing sector were reviewed and guidelines on the distribution of Malaysian equity for joint venture projects were introduced (Malaysian MITI 1994). By 1990, the

[10] Literally, "sons of the soil."

bumiputera share of the corporate sector (by individuals and through trust agencies) had risen substantially (Gomez 1994).

In 1990 the NEP was replaced by the *National Development Policy* (NDP) which placed greater emphasis on redistribution through rapid growth. Malaysia aspires to become a fully developed country by 2020 with the manufacturing sector providing the main source of growth. The NDP is pursuing the participation of bumiputeras without the use of specific numerical targets (Malaysian MITI 1994).

A.9.1 Industrial Co-ordination Act 1975

The *Industrial Co-ordination Act 1975* (ICA) is intended to ensure orderly development and growth in the manufacturing sector through a manufacturing licensing system. Manufacturing companies with shareholders' funds of at least RM2.5 million (about A$1.3 million at late 1995 exchange rates) or employing 75 or more full-time workers must apply for a manufacturing licence.

Approval of an application depends on whether 'the issue of a licence is consistent with national economic and social objectives and would promote the orderly development of manufacturing activities in Malaysia' (ICA, s.4). Appeals against the refusal of a licence, or against conditions in a licence, may be lodged with the Minister but no judicial appeal is allowed against the Minister's determination of any appeal (ICA, s.13).

A.9.2 Industrial Master Plan and incentives

The *Industrial Master Plan* (IMP) provides the framework for developing the manufacturing sector over the ten years commencing 1986. The plan encourages investment in specific priority products for development and export, including tyres, oleochemicals and processed palm kernel oil (from the palm oil industry), cocoa products, fruit and vegetables, furniture, fertilizers, solder, pewterware, consumer products and apparel. Priority products for development and domestic use include polypropylene, cement, float glass, ceramic tiles, basic machinery components, foundries, machinery design capabilities, flat iron and steel products, iron and steel sections, passenger cars, small ships and textiles.

These formed the basis for an extensive and detailed list of promoted products and activities which qualify for income tax relief under the *Promotion of Investments Act 1986*. While the government is undertaking a continuing downward review of the tariff structure, and recognises the need for a general rationalisation of tariffs

and trade liberalisation, some industries may also qualify for infant industry protection.

In its latest review of the IMP, the Malaysian Ministry of International Trade and Industry observed that Malaysia is now targeting industries with higher levels of local content, technology and value added. The future emphasis of policy will be in the areas of microelectronics, computers, information technology, biotechnology, communication technology and advanced materials technology (Malaysian MITI 1994).

END OF APPENDIX

APPENDIX: REGULATION REFORM IN AUSTRALIA AND OVERSEAS 87

Glossary

Accreditation	A voluntary *registration* or *licence*.
Airshed	A basin of air, usually marked by geographic features, in which ambient pollution is contained.
Authorised code of practice	In the UK, a commentary on a *statutory instrument* in non-legal language providing practical guidance about how regulations apply to different circumstances and which alternative methods may be adopted to comply with them.
Certification	See *accreditation*.
Cleaner production technologies	Technologies which are less polluting in terms of energy and raw material usage, emissions to air, land and water from production processes and the environmental impact of the products themselves.
Code of practice	Set of rules specifying appropriate conduct for particular aspects of a business. They are defined in this report to be voluntary. In the UK, the term refers to a set of formally binding rules issued by an agency: for the purposes of this report, these are termed *mandatory codes of conduct*. See also *authorised code of practice* (voluntary)
Compliance cost assessment	A structured evaluation by UK government departments of policy proposals likely to affect business leading to an estimate of the likely costs to business of complying with new or amended regulations.
Composite licence	A licence which consolidate and replace the requirements of an existing set of licences.
Compulsory contract	A contract which a business must enter with one of a number of potential parties for the supply of services.

Conformance assessment	The process of determining whether or not a product or system meets a required standard.
Co-regulation	*Direct regulation* by an industry association combined with government oversight or ratification.
Direct regulation	Regulatory methods which do not rely on *voluntary mechanisms* or *fiscal instruments*. They include *standards*, *compulsory contracts*, *co-regulation*, prohibitions on the manufacture or use of products, price controls and *licences*.
Fiscal instruments	Taxes, subsidies and tax concessions on output, production, resource use and emissions.
ISO 9000	A set of *quality assurance system* standards developed by the INTERNATIONAL ORGANISATION FOR STANDARDS.
ISO 14000	A set of *environmental management system* standards developed by the INTERNATIONAL ORGANISATION FOR STANDARDS.
Licence	A *notification* which also requires prior approval as a condition for conducting prescribed business activities, and compliance with specified minimum *standards* — breaches of which may result in the suspension or revocation of permission by a specified agency.
Master licence	An integrated licence approval system allowing many licence approvals to be obtained through a single application.
Mobile sources	Motor vehicles and other forms of transport which contribute to air pollution. See also *stationary sources*.
Negotiated rule-making	A proposed system of regulation in which firms write their own legally enforceable rules which are ratified by a regulatory agency and enforced by the firm through an independent inspectorate. It is claimed that it would produce simpler rules, more quickly adaptable to new conditions and to which businesses would be more committed.
Notification	An instrument created under government authority requiring all businesses with specified characteristics to provide information about their attributes to a specified agency.

OECD — ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT.

Point source — Readily identifiable and monitored sources of pollution, for example, chimney stacks, exhaust and drainage pipes.

Risk assessment — Identifying and analysing the risks and evaluating remedies, including those already in place.

Self-regulation — Regulatory control exercised by individual businesses or industry associations without government oversight or ratification. Some commentators use this term to describe regulatory arrangements defined under *co-regulation* in this report.

Stationary sources — Non-mobile sources of pollution, for example, chimney stacks and drain pipes. See also *mobile sources*.

Standard — A mandatory or voluntary requirement that

- imposes sanctions for certain harmful consequences from a product or service;
- requires certain conditions of quality to be met at the point of supply; or
- compels the supplier to use certain production methods or materials, or prohibits the use of certain production methods or materials.

Tradeable permits — Dischargers of pollutants operate under some multi-source emission limit and trade is allowed in permits adding up to that limit. If a discharger releases less pollution than its limit allows, it can sell or trade the differences between its emission reduction credits to another discharger which then has the right to release more than its initial limit allows. Trades can take place within a plant, within a firm or among different firms.

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