

The Standard Cost Model: when “better regulation” fights against “red-tape”

Abstract

This chapter introduces one of the “better regulation” instruments, the Standard Cost Model (SCM), a method for measuring the administrative burdens imposed by regulation on businesses. It examines the content and purposes of the SCM. It discusses some of the limits of the model and difficulties that public administrations may face in its application and provides recommendations for improving the model. It describes recent applications of the SCM, with a particular focus on the UK and European Commission experiences. It is argued that the introduction of such methodology in the Impact Assessment guidelines may have an effect on the EU “better regulation” agenda, namely shifting the regulatory pendulum to a more de-regulatory dimension.

1. Introduction

One of the central concepts of “better regulation” is to ensure that the government refrains from issuing regulation which is not strictly necessary (BRTF, 2005). While Regulatory Impact Assessment is the main instrument in the phase of proposal of new regulation, the Standard Cost Model (SCM) specifically sets out to eliminate either in part or whole legislation which imposes excessive administrative compliance costs on businesses. The reasons for analysing the Standard Cost Model are numerous. Firstly, no academic research has critically reviewed the SCM methodology. Secondly, the application of the SCM involves resources from public administrations and calls for questions as to why public institutions make use of the model. Thirdly, as the empirical use of the SCM is limited to a small number of countries, it is relevant to understand what lessons can be learned from such experiences. Fourthly, even if the model is not designed to be statistically significant, it is worthy of note to stress its limits in order to improve its future application. Fifthly, the applications of the model differ substantially. The EU, for instance, is applying the SCM on the basis of the concept of net administrative costs which differs substantially from Member States experiences. Is the “better regulation” agenda destined to change after the introduction of the SCM in the Impact Assessment guidelines?

In order to address these points, this chapter develops as follows. Section 2.1 provides a description of the model. As the existing manuals refer to different typologies of costs, section 2.2 places the category of administrative compliance costs measured by the SCM in the ordinary scheme of legislative costs. Section 3 examines the existing literature on business requests for less (or more) regulation. The purpose is to try to define whether businesses constantly require less regulation or the demand of regulation varies. Section 4 provides a case study of the UK application of the model. Section 5 provides an analytical critique of the model and some suggestions for improvement. Section 6 describes the EU application of the model and argues that the SCM has the potential to move the EU “better regulation” agenda to de-regulatory grounds.

2. The main concepts of the SCM

The Standard Cost Model is a method for measuring the administrative burdens for businesses imposed by regulation. Its quantitative methodology is applied by different public administrations to determine the administrative burdens related to existing and new legislation. The SCM can be used to measure a single law, selected areas of legislation or to perform a baseline measurement of all legislation in a country. The main aim of the model is to ensure that existing regulations and new regulations do not impose excessive administrative burdens to businesses. The focus is not on the policy objectives of each regulation: the measurement focuses only on the administrative activities that must be undertaken in order to comply with regulation and not whether the regulation itself is reasonable or not.

The next section explains the methodology of the SCM and the main formulas.

2.1 The SCM methodology for measuring administrative costs: the concept of information obligations

The SCM methodology is an activity-based measurement of the businesses’ administrative burdens, breaking down regulation into a range of manageable components. These are information obligations, and are the units of measurement of the model. They can be defined as the obligations arising from regulation to provide information and data to the public sector. In other words, an information obligation is a duty to procure or prepare information and subsequently make it available to either a public authority or a third party. It is an obligation businesses cannot decline without

coming into conflict with the law (IWGAD, 2004). An information obligation does not necessarily mean that information has to be transferred to the public authority, but may include a duty to have information available for inspection or supply on request. Typical examples of information obligations are: drawing up and registering annual accounts, applying for permits, general obligations to retain businesses records, provision of information on sick employees to working conditions services, annual statement of employee insurance to social security body (BRE, 2005).

For each information obligation price and quantity are calculated as follows:

Price (Π) consists of a tariff (W), i.e. wage costs (plus overhead, non-wage costs) for activities done internally or hourly cost for external service providers and time (T), the amount of time required to complete the activity. Wage data is normally taken from statistical sources. For external costs a national average figure is used.

Quantity (Q) comprises of the size of the population (P) of businesses affected and the frequency (Φ) that the activity must be completed each year.

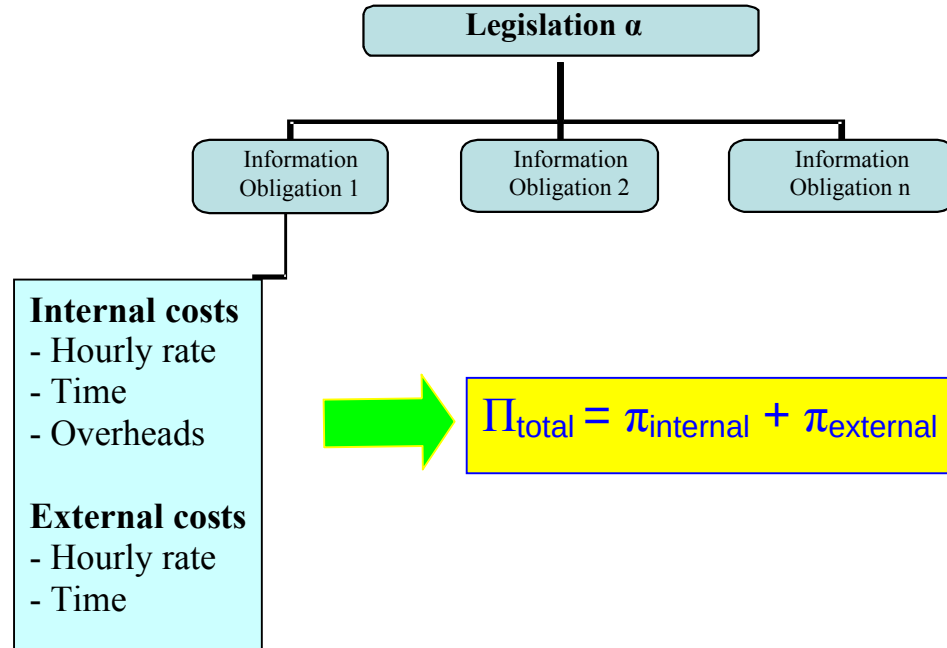
The following basic SCM formula provides the activity costs related to a single information obligation:

$$\text{Activity Cost}_{(IO)} = \Pi \times Q = (W \times T) \times (P \times \Phi)$$

Activity costs can be defined as the costs of the administrative activities that businesses are required to conduct in order to comply with the information obligations that are imposed through regulation. Each piece of legislation may impose several information obligations, as illustrated in Figure 1. Total prices can be expressed as the sum of internal and external prices. The time and money that an entrepreneur spends drawing up and publishing an annual statement with the use of the services of an accountant, hired via an accounting firm office results in the external price. The time the entrepreneur spends correlating and passing on the information that the accountant needs is the internal price. If no external consultancy of professional accounting

advice is needed the external price will be nil ($\pi_{\text{external}} = 0$) and the administrative activity will be attributed internally ($\Pi_{\text{total}} = \pi_{\text{internal}}$).

Figure 1-Costs related to each information obligation



For example, an administrative activity takes $T=5$ hours to complete and the hourly cost of the member of staff in the business completing it is $W=15$ Euros. The price is therefore $\Pi=5 \times 15 = 75$ Euros. If this requirement applied to $P=50,000$ businesses who each had to comply $\Phi=2$ times per year, the quantity would be 100,000. Hence the total cost of the activity would be $100,000 \times 75 = 7,500,000$ Euros.

The overall administrative costs related to one regulation results in the sum of all information obligations:

$$\begin{aligned} \text{Activity Cost}_{(\text{Legislation } \alpha)} &= \text{Activity Cost}_{(\text{IO } 1)} + \text{Activity Cost}_{(\text{IO } 2)} + \dots + \text{Activity Cost}_{(\text{IO } n)} = \\ &= \sum (\Pi_i \times Q_i) = \sum (W_i \times T_i) \times (P_i \times \Phi_i) \end{aligned}$$

Where $i = (i_1, i_2, \dots, i_n)$

The SCM therefore measures the costs related specific administrative activities. The next section places these costs in the ordinary scheme of the costs imposed by regulation.

2.2 Regulatory costs and Standard Cost Model

Every legislation imposes different costs on businesses, the state, private individuals and private households. The existing SCM manuals mention different categories of costs. This section specifies which costs are measured by the SCM, starting from the distinction between private and social costs.

Private costs and social costs

Private costs for individuals and households are what any one person or one family gives up due to the legislation. Sometimes regulators carry out Cost-Benefit Analyses that seek to assess private cost components only. This happens when the regulation is expected to have effects mainly on single citizens and consequently involves distributional issues. An example is contained in the Cost-Benefit Analysis developed in 2000 within the Italian Presidency of the Council of Ministers for a new regulation introducing mandatory helmets for all moped drivers (Law 472/99): it was estimated that one-off capital costs would amount to 45 Euros per each consumer purchasing a new helmet. Normally Regulatory Impact Assessments focus on the cost to society as a whole from an event, action, or policy change (EC, 2005). Social costs are what the society gives up to the legislation. They include negative externalities and do not count costs that are transfers to others, in contrast to private cost.

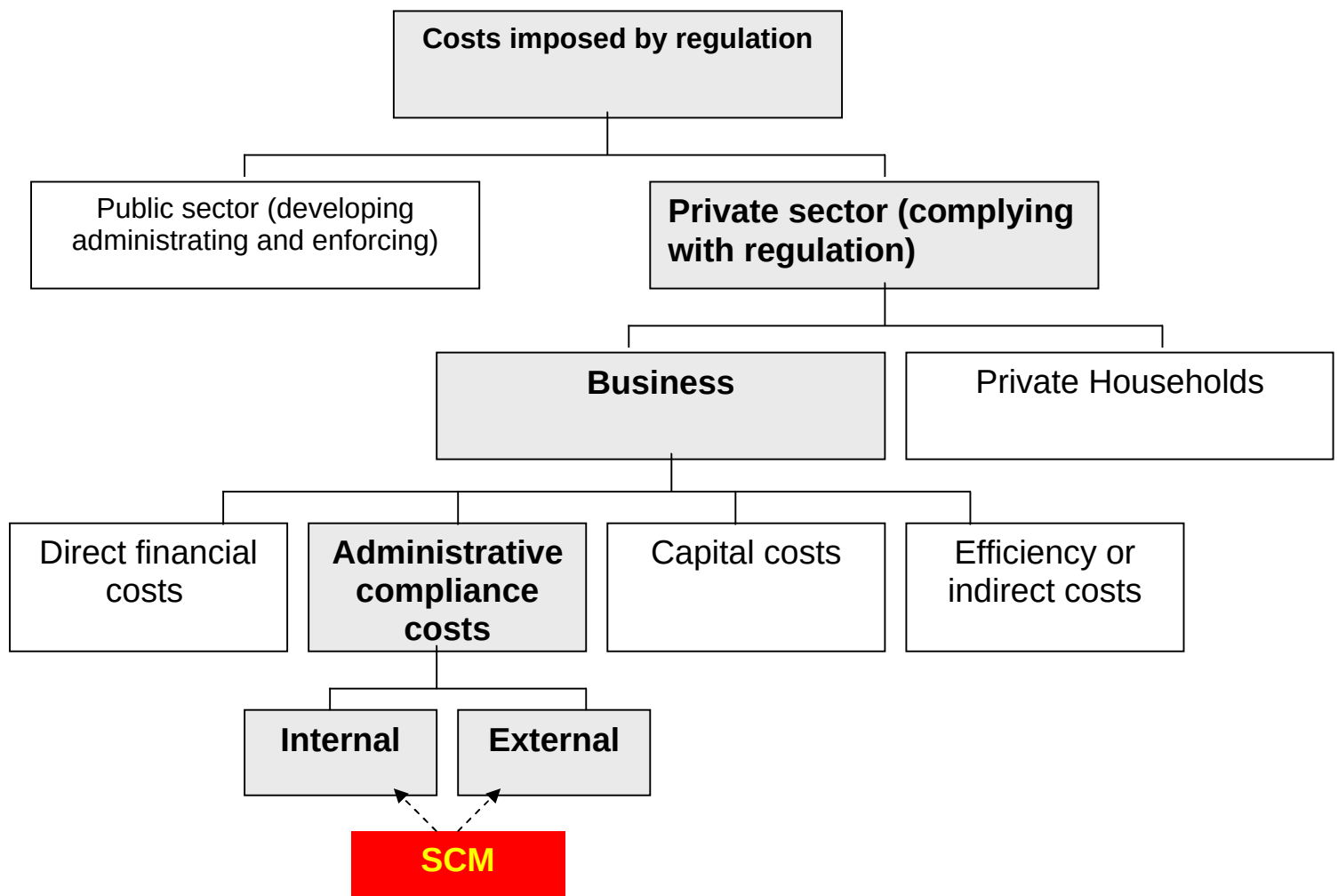
The equation for net social costs is:

$$\text{Net social costs} = \text{Net private costs} + 3^{\text{rd}} \text{ Party costs} - 3^{\text{rd}} \text{ party gains}$$

When no 3rd party costs are foreseen, they can be replaced by public spending. Public spending can derive from developing, administrating and enforcing the new regulation. In the case of the mandatory helmets in Italy, the net social costs were expressed as: net private costs (85 Euros x 200,000 new helmets per year) + public spending costs expressed as annual average costs for additional vigilance activity (10.5 Million Euros) – public spending gains expressed as avoided annual direct costs for head-injury hospitalisation (67 Million Euros). The resulting net social costs are negative, i.e. they represent the sum of benefits per year of the new law less the relative costs.¹ Figure 2 provides an idea of the division of legislative costs between private households, businesses and public sector.

¹ In this case, discounting the cash-flow over five years with a discount rate of 5%, a Net Present Value of approximately 152 million Euros is obtained.

Figure 2-Scheme of costs imposed by regulation



The SCM in the scheme of costs imposed by regulation

The Standard Cost Model focuses on the administrative compliance burdens that legislation imposes on businesses. In particular, it measures those administrative activities businesses only conduct because regulation requires it. It does not take into account the costs that legislation imposes on private households or the public sector. Similarly, it does not consider direct financial costs, i.e. the direct obligation to transfer a sum of money to the Government or the competent authority (including administrative charges, taxes, etc.); capital costs, i.e. the total price spent in purchasing depreciable property (including buildings, equipment, etc.); or efficiency or indirect costs, i.e. lost innovation for time spent in non productive activities. The UK government simplifies the cost categories represented in Figure 2 differentiating

between policy costs and administrative costs: policy costs can be viewed as the essential costs of meeting the policy objectives while administrative costs usually arise from familiarisation with the requirements, monitoring and enforcement, proving compliance etc. Administrative burdens placed on businesses, charities and the voluntary sector are identified using the SCM.²

Recurring costs and one-off costs

The SCM measures mainly recurrent administrative costs from regulation. Recurring costs are the administrative costs that the businesses constantly have in complying with the information obligations from regulation. They may be costs that arise at regular intervals, e.g. with VAT returns. They can also be costs that arise at irregular intervals for the individual business, e.g. if they are to apply for an export subsidy or submit a planning application. They can similarly be an administrative task that the individual business only experiences on one occasion, e.g. in connection with business registration where one applies for a VAT number or upon application for authorisation. The recurring costs differ from one-off costs which are only sustained once in connection with the businesses adapting to a new or amended legislation/regulation. This does not include the costs that a business may have in relation to complying with existing regulations for the first time, e.g. as a consequence of increased turnover or expansion with new areas of activity in the business. As such only the introduction of a new or amended regulation can give rise to one-off costs. The one-off costs are not included in the SCM measurement. However they do form part of ex-ante measurements for inclusion in a regulatory impact assessment. An example is the requirement for firms to read guidance as a result of a one-time change in a regulation.

3. Why the Standard Cost Model?

The application of the SCM is not trouble-free. It requires a significant effort by public administrations in terms of resources. It involves work both internally (co-ordinating unit and government departments) and externally (consultants contracted

²http://www.cabinetoffice.gov.uk/regulation/reviewing_regulation/reducing_admin_burdens/what.asp. For the UK implementation of the SCM, business is all organisations defined as being in the private sector by the Office for National Statistics when compiling the National Accounts. This includes charities and the voluntary sector.

for interviewing stakeholders and quantifying available data). There are two main reasons why public administrations make the effort of measuring and then reducing administrative compliance costs: these costs are of a non-productive nature and create frustration across business.

3.1 Eliminating non-productive costs

The SCM is an attempt by the public sector to get rid of the excessive regulatory work produced in past, present and future administrations. In this regard, the SCM, as part of the “better regulation” agenda is a considerable endeavour to favour the business community. Intuitively, money spent in fulfilling administrative tasks does not benefit the economy and cannot be re-invested in profitable activities. At the macroeconomic level, as an effect of diminishing administrative burdens, the GDP would increase in the medium term because the time and money saved is redeployed in more productive activities (BRTF, 2005). Albeit reasonable, this statement is just a hypothesis since it assumes that businesses in medium term would invest to strengthen their production. This hypothesis cannot be corroborated with empirical evidence because the SCM measures only administrative burdens and does not investigate into efficiency costs or opportunity loss (i.e. how much businesses actually lose due to administrative activities). The model ignores what happens in terms of internal business management including, how productive activities get stimulated as a consequence of less administrative functions. Section 5 on criticisms and recommendations for the SCM discusses extensively this issue.

3.2 Business complaints on administrative burdens of regulation

Businesses complain that they spend too much time and money on complying with government request for information (Pollack, 1985). They claim that government requests for information are unclear and do not understand why they are made so often or why they need to be repeated. They are irritated by the amount of time and money spent filling in forms and would prefer to spend their time and effort in more productive activities, rather than having to fulfil ‘administrative burdens’. Previous studies pointed out that industry tends to exaggerate the costs imposed by environmental regulation (Stirling, 1997). Businesses position about regulation in general, changes according to the advantages and disadvantages that this may bring

about (Ogus, 2004). Does more regulation always mean more administrative costs for businesses? Do businesses always require less regulation?

Economic benefits of ad hoc regulation

The conventional political economy model of regulation holds that stricter regulatory standards are more likely to be accepted if businesses benefit economically from the particular regulation (Stigler, 1971). Firms considering regulation to be necessary may ask for *ad hoc* regulations, which will improve the industry profits. In other cases, businesses will oppose any type of regulation which does not bring about economic benefits.

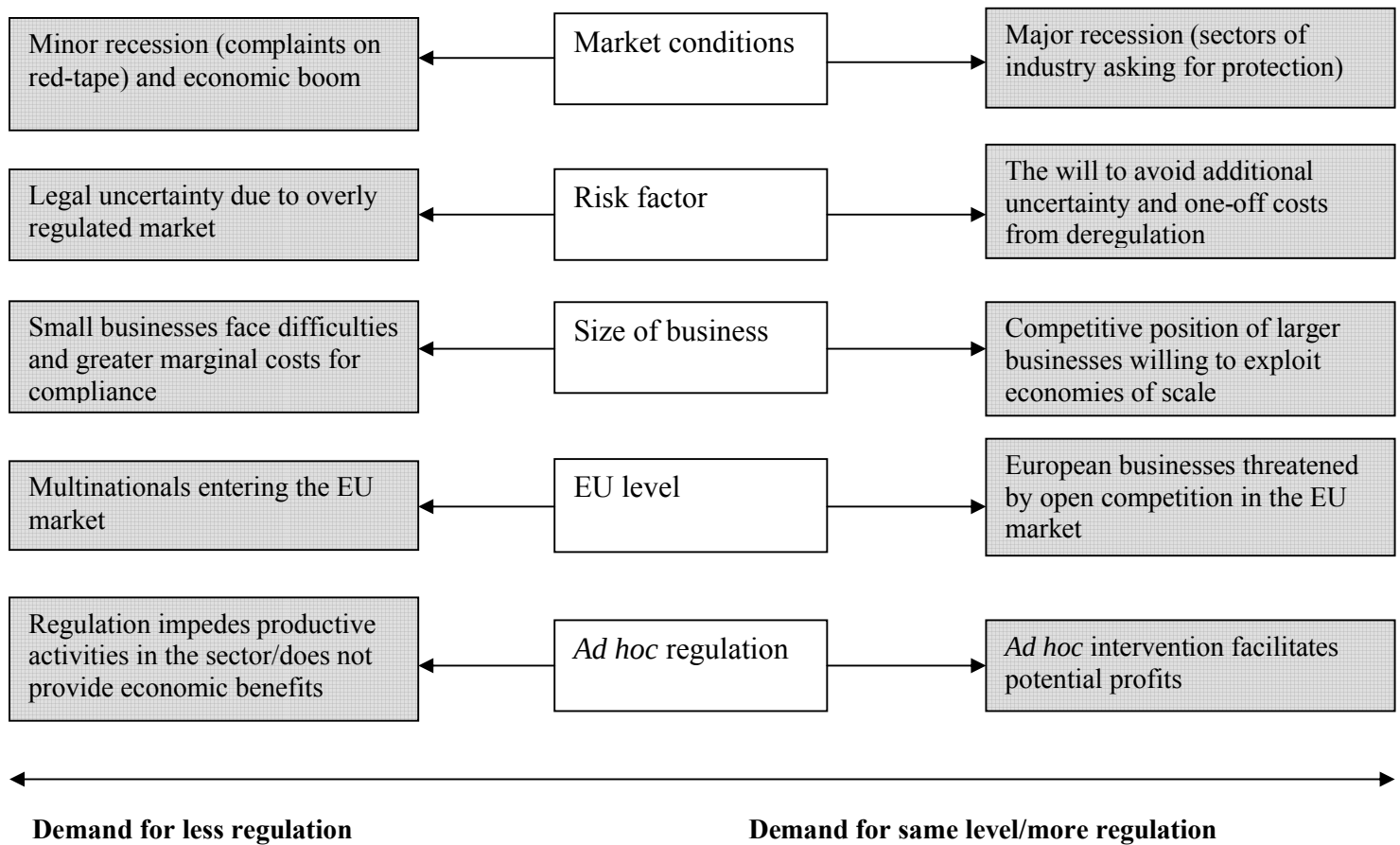
Size of the business

The request for tighter or more lenient regulation by individual firms or groups of firms within a specific industry may change according to differences in industrial structure and competitive position. Large firms could apply pressure for stricter environmental or consumer regulation that would be too costly for smaller firms to implement, whereas smaller competitors within the same industry could contest such regulation (Bernauer and Caduff, 2004).

EU level

At the EU level, European firms may require more protection, whereas multinationals may ask for an enhanced deregulation of the market (Majone, 1993). Much has been written about the proposal on Registration, Evaluation and Authorisation of Chemicals (REACH), and complaints of the chemical industry about excessively restrictive regulation on chemical products. However, an example of requests for stricter regulation on non-European companies comes from chemical industries: this issue was raised at the Joint European Commission/CEFIC Conference on "*The Impact of New Regulatory Requirements on the Chemical Industry and its Competitiveness*", Brussels, 5 October 2000. "The unfair competitive advantage afforded to companies from non-EU countries, who have full access to the European Single Market without respecting EU legislation on chemicals, is of increasing concern to the European Chemical Industry. While the European Chemical Industry openly welcomes international competition and free-trade, we find it, to say the least, inequitable to allow non-EU country competitors to take advantage of all the benefits of the Single Market without contributing to the accepted costs involved in EU environmental regulation".

Figure 3-Factors influencing Business demand for regulation



Risk factor and market conditions

Businesses tend to complain about excessive regulation especially in periods when markets do not function efficiently (Cecchini, 1988). One of the main reasons why excessive regulation is not welcome is that it brings about uncertainty and distracts businesses from productive activities. However, in some cases even de-regulative measures provide uncertainty and additional costs as stakeholders may face one-off costs to fully understand and get appropriate administrative measures in place to comply with the new (lighter) regulatory regime. Evidence suggests that companies either support or oppose regulation according to their corporate strategies (Fisher, 1994).

Figure 3 shows how the demand for more or less regulation by business and industry changes depending on macro-economic and risk factors. The factors for demand of regulation analysed in this chapter are far from exhaustive. The reader should

interpret them as a possible explanation for changing patterns in demand of regulation. However, these factors chapter may influence the future profile of the “better regulation” agenda, which is designed to suit the needs of the business community.

4. Applications of the SCM

The Standard Cost Model can be applied both *ex ante* and *ex post*. The anticipated administrative consequences of a draft law, draft executive order or other initiative can be contained in the Regulatory Impact Assessment. Similarly, the results from an *ex-ante* measurement, for example, may form part of the overall consequence assessment of a bill’s economic and administrative effects on the public sector, businesses, citizens, environment etc. The *ex-post* application of the SCM consists of the measurement of the administrative costs that arise after a regulation has come into effect and has been able to have an impact on businesses. In this case the SCM entails the factual administrative consequences for the businesses in respect of an implemented law, statutory instrument or other initiative. An *ex-post* measurement is carried out when an initial measurement is to be made of the overall administrative costs in an area of regulation, known as a baseline measurement (BRE, 2005). A baseline measurement, as carried out in the UK, is a statement of the overall administrative costs that businesses have in following a current set of regulations at a given point in time.³

The SCM was initially developed in the Netherlands and has also been extensively applied in Denmark among other countries. The international SCM framework is explained in the Administrative Burden declaration⁴ that sets out the SCM approach in summary and the International Standard Cost Model Manual (IWGAD, 2004). The Standard Cost Model is to date the most widely applied methodology for measuring administrative costs (OECD, 2004). In 2003, a network of European countries was formed to consistently apply the Standard Cost Model. The SCM network currently consists of Austria, Belgium, Flanders (Belgium), Czech Republic, Denmark, Estonia,

³ *Ex-post* measurements are also conducted in order to keep the baseline measurement updated with the consequences of new or amended regulations. The BRE (2005) manual suggested that three years after implementation is an appropriate time for this to occur. At this time the *ex-ante* estimates of the administrative costs produced at the time of implementation can be reviewed and updated if necessary.

⁴ http://www.administratievelasten.nl/default.asp?CMS_TCP=tcpAsset&id=5B09EDCA525141E2866D881AB2C43157

Finland, France, Germany, Hungary, Italy, Ireland, Latvia, Luxembourg, the Netherlands, Norway, Poland, Sweden and the United Kingdom.

4.1 The UK experience

Following on the Dutch and Danish experiences, the Better Regulation Task Force (2005) recommended that the UK government should measure and reduce the administrative burdens of existing legislation. The measurement of administrative burdens in UK legislation consisted of a one year intensive exercise. The application of the SCM by the UK government was part of a wider “better regulation” initiative to reduce regulators and inspectorates from 31 national bodies to 7, introduce new legislation to speed up the process of de-regulation and make EU transposition easier. The Better Regulation Executive within the Cabinet Office held the responsibility for applying the SCM and co-ordinating the *ex-post* measurement. It was an unprecedented, ambitious and resolute program. The measurements were carried out involving 16 government departments. The quantitative measurement was conducted by external consultants who carried out 8500 interviews with businesses to understand how much time they spend on administrative activities. Estimates of the time taken for each of the 20000 information obligations measured, are obtained for a 'normally efficient' business.⁵ In addition, 200 expert panels were used to assess areas of regulation that are particularly complex, apply infrequently, or which affect only a small number of organisations. The UK Government effort to measure administrative burdens is unique so far. Indeed, the volume of information produced is appreciable, especially considering the limited amount of time available. This exercise also stressed some of the problems related to the application of the SCM which are explained below.

4.2 Matters arising from the UK experience

The UK measurement is particularly ambitious because it covers all business-related regulations with information obligations and data requirements. All regulation under the control of the central Government is within the scope of this implementation. Also included are EU rules as well as international conventions, to the extent to which they are implemented domestically. Originally, segmentation of UK businesses was

⁵ The normally efficient business means businesses that handle their administrative tasks in a normal manner, i.e. those businesses that handle their administrative tasks neither better nor worse than may be reasonably expected.

foreseen to reflect differing cost/resource structures in businesses and the incidence of particular regulations. The idea is that firms of different sizes face different resource and cost constraints. A regulatory change may be substantially less significant in its impact on a large business, with resources dedicated to dealing with such changes, when compared with a small business where taking on a change means diverting resources from other activities and incurring unplanned costs. The segmentation took place according to the size of firms⁶ and sectors.⁷ More problematic was the classification of industry sectors. Different industry sectors face differing levels of regulation. For example, firms handling certain chemicals must comply with additional health and safety rules in addition to other regulation. Scoping the population and dividing them by industry sector proved extremely difficult due to the high number of typologies of UK firms. Accordingly, many regulations were specific to very small areas of businesses. One lesson learnt of the UK application of the SCM is therefore that the model does not work well when the population of businesses (and consequently regulations) is divided into a large number of sectors. Box 1 explains how the application of the SCM varies depending upon how the business population is distributed across sectors. It provides an example which simplifies some methodological observations derived mainly from the Dutch and UK experiences.

⁶ Four size bands as far as practicable. The size bands to be used are those defined by the Small Business Service: Micro (0-9 employees); Small (10-49 employees); Medium (50-249 employees) Large (250 or more employees).

⁷ The SCM normally-efficient business-based measurement approach means that in general splitting the measurement by industry sector is not necessary. Sector breakdowns can be derived using statistical population information. For sector specific regulations the measurement must be segmented to reflect the coverage of the regulation. In general, industry sector should be recorded using the Standard Industrial Classification 2003 (SIC 2003) published by the Office for National Statistics. In many cases the SIC was not sufficiently detailed where regulation covered very specific areas of business.

Box 1-SCM and business population: two simple examples

N: number of businesses

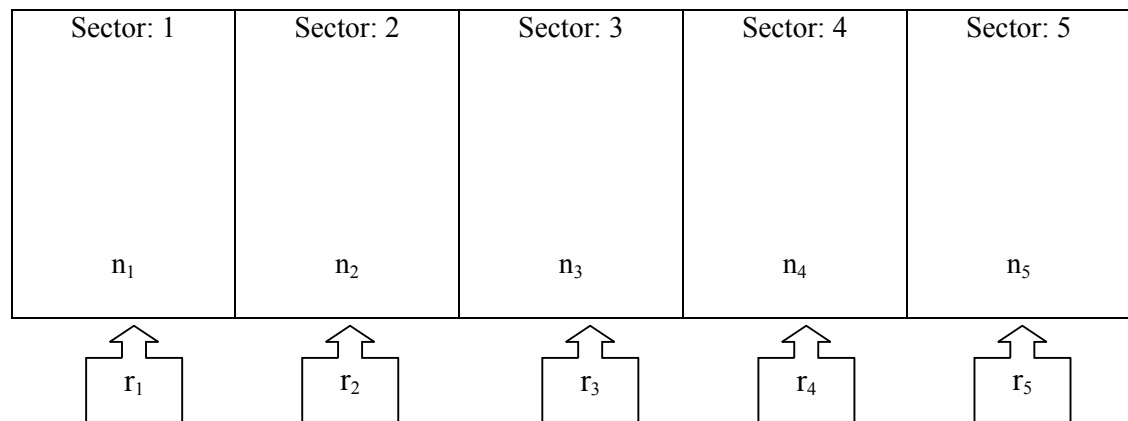
S: number of sectors

R: number of regulations

The SCM does not function properly when businesses are spread in many sectors. The extreme case would be that the number of businesses equals the number of sectors. Consequently the level of regulation is at least as much as the number of sectors:

$$N = S \leq R$$

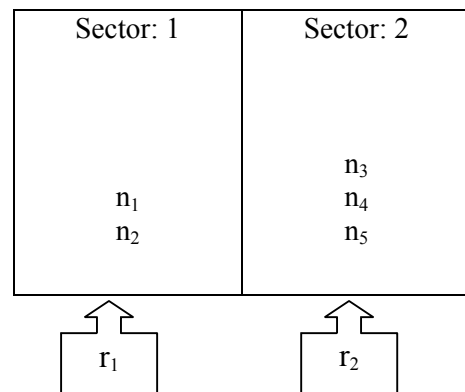
The figure below shows a simple example of a country where there are 5 businesses that operate in 5 different sectors. Each sector is regulated by at least one or more regulations.



The SCM works better when businesses are concentrated in few sectors. Assuming that each sector requires the same degree of regulation as in the example above, the number of regulations per each sector will be less than the number of businesses:

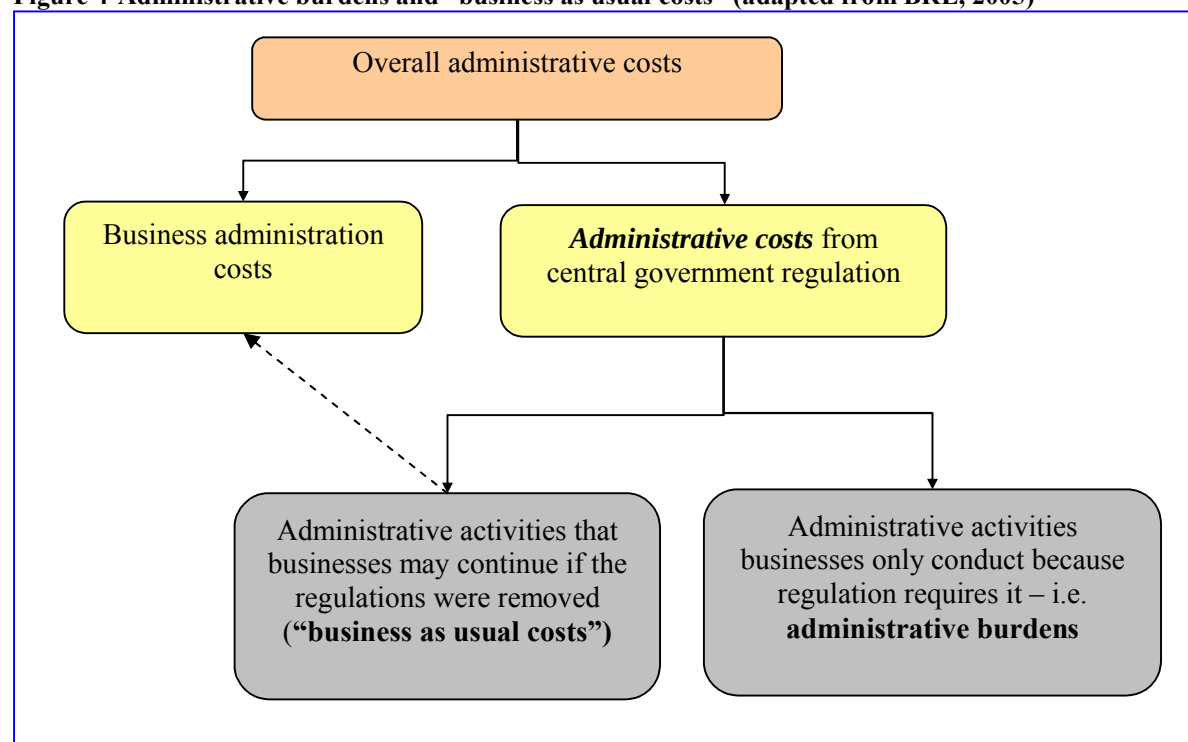
$$R \geq S \text{ and } S < N$$

The figure below shows a case of a country where there are 5 businesses that operate in 2 different sectors.



Besides the problems of segmentation of businesses, the UK measurement exercise proved extremely difficult due to the lack of information and reliable data to employ at the beginning of the exercise: departments did not know how many businesses they regulated or how much regulation they had produced to date. Given this premise, the creation of the baseline for information obligations was far from being scientifically exact. An additional drawback was that the measurement was skewed by the inclusion of costs that are not administrative burdens. In other words, the SCM should measure the administrative burdens that businesses face due to compliance with regulation. This excludes administrative activities that businesses may continue if the regulations were removed (see figure 4). Towards the end of the exercise, the Better Regulation Executive identified this problem and named it as “business as usual” costs, i.e. costs of activities which businesses would be likely to carry out regardless of the regulation in place. For example, businesses would continue to keep some element of accounts even without legislation. As the “business as usual” costs problems was identified late in the exercise, the data previously collected did not allow for identifying them. Hence an *ad hoc* methodology was introduced to reduce the impact of such costs on the overall measurement.⁸

Figure 4-Administrative burdens and “business as usual costs” (adapted from BRE, 2005)



⁸ Instead of reviewing the 20000 information obligations individually, weights were attributed to some 300 information obligations.

5 General criticisms at the SCM methodology

Besides the matters which arose from the practical application of the SCM in the UK, this section presents some remarks about the overall SCM methodology and suggests some recommendations for improvement.

The manuals specify that the SCM was developed to provide a simplified method for estimating the administrative costs imposed on businesses (OECD, 2004). The pragmatic approach to measurement provides estimates which are indicative rather than statistically representative. Moreover, the result of the measurement is only an estimate and, due to the limited sample size and non-random sample design, should not be regarded as necessarily being representative in statistical terms. The UK manual stresses that the method is not static and elements in the method will be constantly developed: “the manual is not definitive, but will be updated in keeping with the method’s continued development” (BRE, 2005). On this premise, a discussion about certain aspects of the SCM methodology may help improve future versions of the model. By knowing the limits of the methodology, it will be possible to understand to what extent this model can be applied in future measurements.

5.1 Criticisms at the SCM methodology

1) The SCM supposes that the money saved on administrative burdens will be re-invested by industry in productive activities. Making a speculation like this implies a degree of certainty about the change in the management assets within firms, including internal shifts of human resources from administration and accounting offices to internal productive functions. Intuitively, the structure of a large size firm does not change because each year there are two less forms to fill in. Arguably, some desks will have to deal with less paper, but this does not necessarily imply the elimination of certain administration job categories which remain fundamental in the management of the business.

2) The effort of calculating and eliminating administrative costs may prove ineffectual if the consequent overall economic improvement cannot be measured. Assuming that companies do benefit from administrative relief, how can this benefit be measured? How can the success of the SCM be measured? The GDP is dependent on too many variables to be employed as a direct indicator for the benefits arising from the suppression of administrative burdens. Moreover, the elimination of certain

administrative fulfilments does not imply the opening of new production units, rendering the GDP an obsolete indicator.

3) The SCM assumes full compliance. This means that the measurement is carried out supposing that all businesses comply with the legislation in place. There are studies that have proven that the level of compliance in certain sectors is not more than 50% of the existing regulation. Sectoral studies, for instance, state that 42% of businesses do not comply with some part of food safety regulations (HSE, 2005). Only in 2003-04, UK national regulators issued 357,000 warnings or enforcement notices, and prosecuted or fined almost 11,000 businesses (HM Treasury, 2005). The assumption of full compliance simplifies the calculations, but takes the measurement far from reality. The full compliance assumption may also bring about inequalities in the phase of removal of administrative burdens. If the SCM does not take into account that industry sectors have different levels of compliance, businesses within highly compliant sectors may end up disadvantaged due to this generalisation. This may occur because the overall administrative burdens of a less compliant sector will be inflated compared to reality: some costs will be attributed to legislations they do not fully comply with. The risk is to match real administrative burdens with inflated, fictional administrative burdens and take decisions based on this unfair matching.

4) The SCM encompasses a one size fits all approach: administrative burdens are expressed as the cumulative value of how much the 'normally efficient business' spends fulfilling a specific administrative activity multiplied by the number of businesses in the country. The main SCM formula is reducible to an average mean where by dividing the overall figure by the number of businesses we can gather how much on average a business spends ($\text{Mean} = \sum P / Q$). Even the concept of 'normal business' is an attempt to identify a discrete frequency whose spending represents the mode value of the population. This approach presents several problems:

- I. No account is made of distributional issues. It is unrealistic that companies spend the same money for fulfilling administrative activities. The model is not capable of distinguishing between, for instance, company A which has the capability and willingness to pay €10 per hour to fulfil an information obligation and company B which is willing to pay €8 per hour and therefore gets a less qualified employee.

- II. It does not weight how much impact administrative burdens have on the wealth of businesses. Even assuming that filling in a form costs €10 per hour to every business, the same €10 has a different weight depending on the size of the business. For example, company A has a turnover of €6 mil. Spending €600 per year on information obligation has an effect on 0.01% of the company turnover. Company B has a turnover of €30000. Spending the same €600 per year on information obligation has a much more significant effect over 2% of the company turnover.
- III. The manuals say very little about how to identify the ‘normally efficient business’.⁹ The process of selection is ambiguous in theory and problematic in practice. Even admitting that, per sector, there is a normal area of businesses that operate in normally efficient conditions, this would completely exclude areas of business which face administrative burdens possibly far from the average values.

5) The SCM takes for granted the constructive collaboration of businesses in the interview phase. The SCM requires wide stakeholder participation (about three businesses per sector). Nevertheless, the UK experience suggests that businesses are not always collaborative. The director of the Better Regulation Commission, Rick Haythorwaite, deplored businesses for the lack of support during the SCM exercise.¹⁰

5.2 Recommendations to improve the SCM methodology

1) Research is needed to understand how businesses re-invest once they are relieved from administrative burdens. A full understanding of how individual firms of different sizes react to the reduction of administrative burdens would be useful. The research could address the following questions: do businesses really re-invest? Do they move into more profitable activities? Does the structure of the business change because there are less administrative duties to comply with?

⁹ “One option is to take a random sample and start to contact the businesses to arrange an interview. When it comes to screening the businesses for interview, the businesses can be asked a few questions with a view to gaining an indication as to whether it is typical of the target group” (BRE, 2005).

¹⁰ “The flow of ideas from business to hel with the exercise had been lamentable” FT, 27 July 2006.

2) How can public administration quantify the benefits of carrying out the SCM? In order to understand how much businesses actually lose due to administrative activities, the SCM model may include the concept of opportunity costs. In this case, opportunity costs would consist of how much each business gives up to fulfil administrative tasks. Opportunity costs provide an understanding of how much the time spent by a single business means in relative terms. Businesses are then asked how they spend their resources in alternative ways to administrative costs. They are subsequently monitored to understand whether and how alternative investments occur. Such investigation could be carried out only on a limited sample of the population. The standardisation and aggregation of opportunity costs gives a rough estimate of the overall benefits of reducing administrative burdens.

3) Instead of calculating administrative burdens on the basis of full compliance, the government should first investigate the actual level of compliance of businesses and hence estimate administrative costs. Alternatively, if the measurement has already taken place, the total value should be weighted with realistic compliance rates, estimated depending on available studies on the sector.

4) The SCM does not take into account distributional matters because the formulas are based on the principle of statistical mean average. The introduction of the deviation standard would integrate the crude SCM figures with some understanding of the distribution of costs through the population. Moreover a measure of statistical dispersion would help distinguish firms, according to the capability to pay for administrative burdens. Contingent valuation may also help understand (i) how much a business is willing to pay for administrative burdens (ii) to distinguish the impacts that administrative burdens have on different businesses.

5) Since businesses do not always co-operate with government, an alternative way of gathering information should be contemplated. The SCM seeks to cover the business population *horizontally*, i.e. collecting data from as many types of businesses as possible. This poses questions about the accuracy of the data collected and doubts about at what level (e.g. junior or senior) employees should be interviewed. An alternative *vertical* technique of data collection may consist of a lower number of businesses interviewed. Interviews carried out with a restricted number of businesses

would allow more time for understanding the actual figures provided by businesses. The selection of the sectors on which to focus the measurement could be strategically made on the basis of those businesses that require less administrative burdens. Ideally, other sectors would volunteer to participate in the measurement once they understand the privileges arising from the relief of administrative burdens from other sectors.

6 The EU measurement of net administrative costs

6.1 Characteristics

The European Commission developed a common approach for assessing administrative costs associated with existing and proposed Community legislation (EC, 2005b). The common approach at EU level uses the Net Administrative Cost Model. The main aim of the model is to assess the net costs of administrative obligations imposed on enterprises, the voluntary sector, public authorities and citizens (net costs = costs introduced by legislation minus the costs suppressed by legislation at EU and/or national level). The European Commission specifies that the model is intended for microeconomic purposes (EC, 2006b), i.e. to assess the administrative costs imposed by a particular piece of legislation. It should be used in the impact assessment of a proposed measure (*ex ante*) and the simplification of an existing measure (*ex post*). Apparently, the EU methodology has not been designed to suit macroeconomic purposes (e.g. increasing the overall GDP in EU Member States). Administrative costs are defined as the costs incurred by enterprises, the voluntary sector, public authorities and citizens that meet legal obligations to provide information on their action or production. Information is taken in a broad sense, including costs of labelling, reporting, and monitoring to provide the information and registration. While the calculation will mainly focus on regulatory costs of a recurring nature, one-off costs may also be taken into account (i.e. costs incurred when (re)designing the way administrative obligations will be met).

6.2 Differences with UK approach

With the Net Administrative Cost Model, like for the SCM, an administrative action required by law, but corresponding to what an entity would normally do in the absence of any legal obligation, is not regarded as an administrative obligation. For example, a large part of accounting and auditing legislation corresponds to normal business practice. Table 1 draws a comparison between UK Standard Cost Model and EU Net Administrative Cost Model. Noticeably, the EU model differs in the focus on

Table 1-Comparison between UK Standard Cost Model and EU Net Administrative Cost Model

	UK Standard Cost Model	EU Net Administrative Cost Model
<i>Aim</i>	Assesses only the costs of administrative obligations imposed on enterprises, distinguishing between national and non-national origins. Macroeconomic purpose (estimate of administrative burden on the economy as a whole)	Assesses net costs of administrative obligations imposed on enterprises, the voluntary sector, public authorities and citizens, distinguishing between national, EU and international origins. (net costs = new costs – costs suppressed). Microeconomic purpose (ex ante impact assessment and ex post simplification). No macroeconomic use envisaged
<i>Definition of administrative costs</i>	The costs of administrative activities that businesses are required to conduct in order to comply with the information obligations that are imposed through central government regulation.	Administrative obligations are defined as the costs incurred by enterprises, the voluntary sector, public authorities and citizens in meeting legal obligations to provide information on their action or production, either to public authorities or to private parties. One-off costs may be taken into account.
<i>Core equation</i>	$\Sigma P \times Q$ (Price = Tariff x Time; Q: Quantity = Number of businesses x Frequency). Focus on labour costs and overheads, assumed to be the main input for meeting administrative obligations.	$\Sigma P \times Q$ Where appropriate, types of costs other than wages and overheads will be taken into account
<i>Scope and frequency</i>	Method applied to all regulatory proposals and all acts in force. 1 st Baseline measurement (2005-2006) Baseline needs to be updated to reflect progress on simplification and new regulations	Method only applied to proposals imposing major administrative obligations and/or to acts identified as particularly burdensome by end-users. No sector excluded a priori, but no sectoral or general baseline measurements envisaged either. Only applied to the most onerous actions identified in most cases by means of indicative thresholds (based on time required per action and frequency) Review and timeline defined on a case-by-case basis
<i>Expected level of accuracy & data source(s)</i>	Level of accuracy depends on fieldwork and degree of cooperation by departments. ¹¹	Expected level of accuracy depends on the degree of Member State cooperation. In exceptional cases, high level of accuracy sought via field work, limited to a sample of Member States and/or to a standard sample of the business community, and simulation. This would apply to required actions likely to be particularly disruptive to the work of the enterprise, and data that are sensitive or costly to produce. In standard cases, rough estimate based on available EU statistics, standard ratios and Member States studies.

¹¹Field work: sample of ‘typical’ businesses are interviewed by phone. In cases where telephone interviews did not fit the purpose face to face interviews were carried out.. Selection of businesses for

<i>Determination of the regulatory origin</i>	Decision tree in 3 phases and 14 steps.	Decision tree in 4 steps.
<i>Division of responsibility</i>	Regulatory burdens are costed by departments and consultants, under the guidance and supervision of the Better Regulation Executive (Cabinet Office).	Member States conduct national fieldwork and simulations of typical national firms, while the European Commission defines what is needed to aggregate data.
<i>Report sheet</i>	Standard report template consists of 9 points and 5 annexes.	Standard report sheet including specific columns for EU origin and for transposition 'markers'. Use of a (simplified) typology of administrative obligations only for the ex post assessment of transposition measures.
<i>Methodological caveats</i>	Borderline cases are defined. Borderline cases include: treatment of complaints; differentiation between households and businesses; administrative costs of inspections; tribunals, court cases and investigations; and start-ups and first time compliance cases.	List of limitations of the method used (nature of the assumptions and extrapolations made; reminder that the figures are only approximations / estimates; margin of error). Mention whether EU regulation (and the administrative costs arising from it) replaces national regulations and whether EU regulation is in fact reducing costs to operators; etc.

Adapted from EC (2006b), annexes

proposals imposing major administrative obligations and particularly burdensome acts. The decision to measure the administrative burdens of the most onerous actions may, on paper, reduce the measurement effort. Directorate General Enterprise, for instance, adopted a pilot case approach where the administrative costs of one sector, the building industry, are assessed through interviews with individual businesses. At the EU level, Member States approximatively cover the same role of departments at the national level.

6.3 Dealing with data on costs in the EU

In perspective, the process of gathering and aggregation of the data is even more demanding than at the national level. The experience coming from Impact Assessment is that EU institutions in the phase of proposal of new legislation are struggling with insufficient or too spurious data. The European Commission is not able to guarantee full knowledge of the costs and benefits of future legislation (Hahn and Litan, 2004). To date, cost and benefit rationales do not represent the core foundations for drafting policy proposals (Torriti, 2006). They are supplementary instruments to be used by the European regulator in specific regulatory circumstances, especially when business stakeholders require it. This observation applies also to the (lack of) employment of

interview to cover all segments/data requirements/information obligations to be estimated using interviews. Overall 8500 interviews were carried out.

any economic and risk analysis techniques. It is difficult to predict whether the introduction of a cost model will change the approach by European institutions to economic analysis. One may argue that an increase in the use of economic analytical instruments may induce a wider use of such instruments (Hahn and Malik, 2004). If public servants see the introduction of economic analysis as an imposition, the effect may not be so immediate. As other public institutions, the European Commission comprises public servants of different backgrounds. The existence of teams of economists is not sufficient to guarantee a systematic economic approach to decision-making. In other words, public servants will not start to base their decisions on costs and benefits just because the Secretariat General produces guidelines that recommend the use of SCM or CBA (EC, 2005a).

6.4 The measurement of administrative burdens in the “better regulation” context

The introduction of the common methodology for measuring administrative burdens coincides with a period of fervent stress on the importance of eliminating “red tape”. In a number of business publications and conferences, the blame for the poor performance of the European economy was on the excessive number and rigidity of EU regulations (Robinson, 2004). The conditions were ones of demand for less regulation described in section 3.2. The advent of the Barroso Commission in 2004 corresponded with the highest institutional effort to suit the European business community in the “fight against red tape” (Löfstedt, 2006). In the name of “better regulation”, the Commissioner Verheugen started a campaign of reduction of regulation, calling for a reduction of the *acquis communautaire* by repealing, codifying, recasting or modifying 222 basic legislations and over 1,400 related legal acts in the next three years. The inclusion of the model in the Impact Assessment guidelines (EC, 2005a), could be interpreted as a move of the EU “better regulation” agenda to more de-regulative grounds. One third of 2006 policy proposals were withdrawn (OJEU, 2006). The focus of “better regulation” changed since it was introduced in 2000 by previous European Commission president, Romano Prodi, as an incentive to improve the social and environmental protection in EU regulation. Moreover, as the Net Administrative Cost Model is not about removing pieces of legislation which represent excessive administrative burdens, the European Commission is about to launch a new project in the measurement of administrative

burdens, having significant financial effects.¹² The rationale of the project is to prove that the amount of regulation originating from Brussels is moderate and to give a strong signal to stakeholders of the Commission's commitment to reduce red-tape. The European Commission already knows the policy areas that will be affected by the measurement and the identification of the specific directives, regulations and decisions containing excessive information obligations will be alleviated by the existence of the *acquis communautaire*.

When is the “fight against red tape” due to finish? What is the future of “better regulation”? It is argued here that the focus on administrative compliance costs will decrease once the hostility to regulation declines. Public institutions take action against administrative burdens because the business community requires less “red tape”. Accordingly, the “better regulation” agenda will change again to meet the needs of businesses. An improvement of the European economy may alter the business community's plea to eliminate regulation. The institutional, mainly legal, difficulties of removing regulation and the private industry costs of adapting to a re-regulated regime may induce both parts to refrain from fighting “red tape”. The shift in the demand for less de-regulation will also depend on the size of business and sectoral circumstances of demand for *ad hoc* regulation.

7 Conclusions

This chapter introduced the Standard Cost Model, i.e. a “better regulation” instrument used by public institutions to measure and eliminate the administrative burdens that businesses face due to regulation. The main characteristics and the general mechanism of the model were explained. An overview of the costs generating from regulation was provided in order to clarify which type of costs are measured by the SCM. The chapter explored the reasons why some public institutions are centring their “better regulation” agenda on the administrative compliance costs. It is argued that better regulation is a response of the public sector to the needs of the private sector, above all the business community. Different strands of literature were therefore examined to understand in which cases businesses demand for less (or more) regulation. A set of factors that go into business demand for regulation were identified. The main example of national application of the SCM is from the UK. Starting from the UK experience, part of the SCM methodology was critically reviewed because: (i) the model ignores

¹² The overall cost of the project amounts to around 20 million Euros.

how businesses will re-invest after the administrative relief; (ii) the benefits of the elimination of administrative burdens cannot be measured; (iii) the full compliance assumption is too distant from reality; (iv) the average mean formula does not take into account distributional issues, does not weight how much impact administrative burdens have on the wealth of business and is based on the ambiguous concept of ‘normally efficient business’; and (v) the model is too dependent on business stakeholder participation. Recommendations were put forward to improve the model or future measurements of administrative compliance costs. Finally the chapter discussed the EU common methodology for assessing net administrative costs, comparing it to the UK SCM. The consequences of introducing such methodology were discussed in the wider context of “better regulation”.

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