

# SUBMISSION TO THE AUSTRALIAN SMALL BUSINESS AND FAMILY ENTERPRISE OMBUDSMAN DISCUSSION PAPER 2016

SUBMISSION

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CUT RED TAPE TO

UNLEASH  PROSPERITY

# Executive Summary

The future of many existing and potential Australian small businesses are threatened by thousands of pages of unnecessary red tape at all levels of government.

Small businesses spend disproportionate resources understanding and complying with complex and unnecessary red tape. This means the red tape burden falls hardest on small business, partly because they have often have fewer resources to absorb the cost.

The annual cost of foregone economic output low quality rules and red tape was recently estimated by the Institute of Public Affairs to be \$176 billion. Red tape is now our largest industry and is a tax on our prosperity.

When Australian businesses direct scarce resources to unproductive compliance activities they are prevented from expanding their business and acting entrepreneurially. This holds us back in international markets and threatens the prosperity and living standards we now enjoy.

In this submission we propose that the most important advocacy task of the *Australian Small Business and Family Enterprise Ombudsman* is in tackling Australia's red tape problem because it is only once governments get out of the way that small business can grow.

# The red tape challenge of Australian small business

One good method to gauge the health of small businesses is the rate of business entry and exit. Higher rates of business entry and exit signal the healthy process of economic growth. As the Institute of Public Affairs wrote last year in a submission to the Productivity Commission:

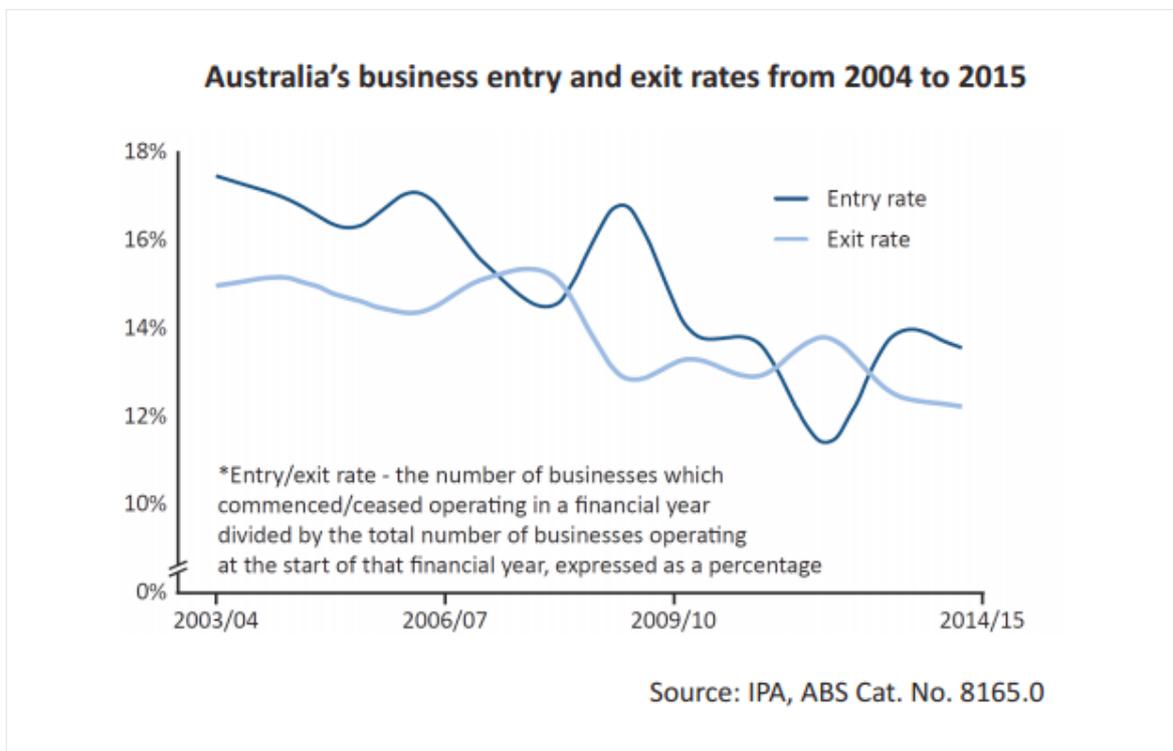
It is a widely held fallacy of aggregation that economic growth of, say, three per cent is achieved when all the businesses in the economy grow by three per cent.

In reality, there are large variations in the productivity and growth of individual firms within an industry.

Economic growth occurs as the outcome of a selective process: high productivity firms expand, and the low productivity firms exit.

Therefore high levels of entry and exit within an industry are a necessary condition for economic growth.<sup>1</sup>

The Australian Bureau of Statistics publishes entry and exit rates for businesses. As shown in the graph below, both figures have been in precipitous decline - business entry and exit rates in 2014/15 were lower than one decade earlier.<sup>2</sup>

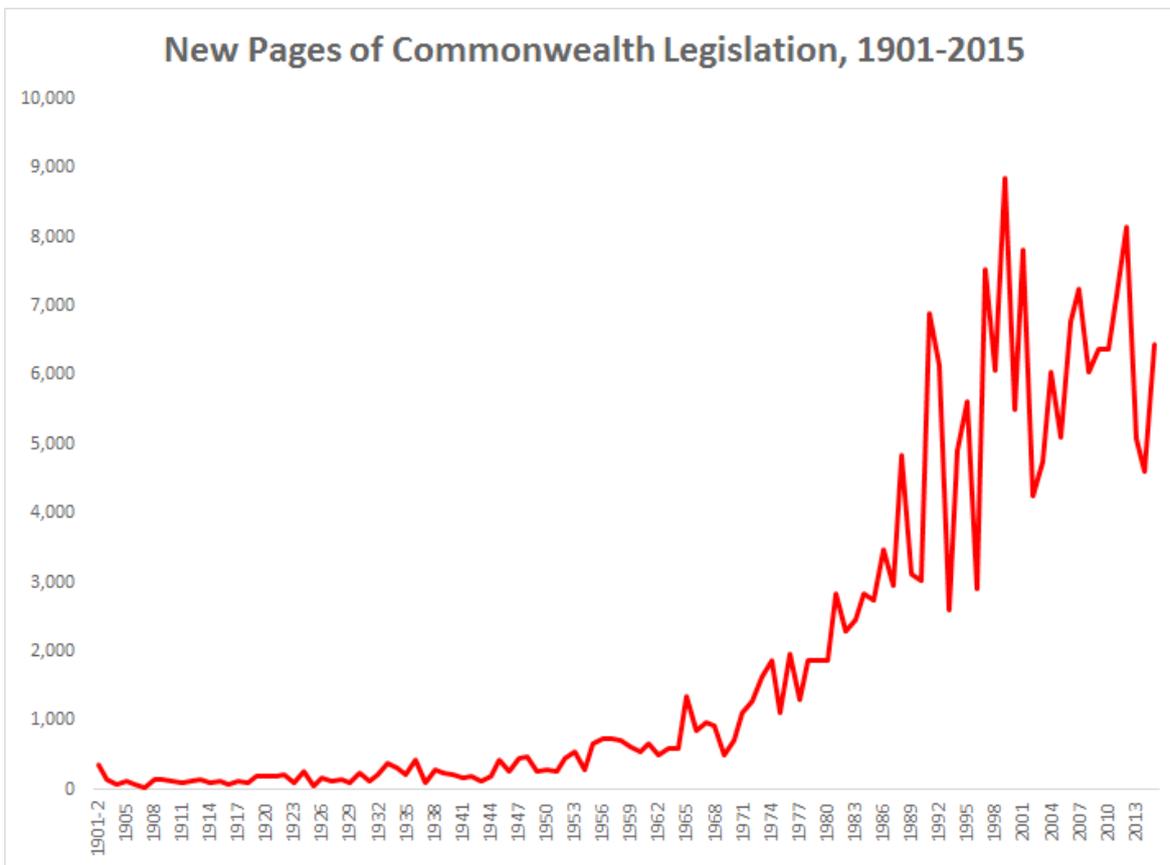


<sup>1</sup> Allen, D. and Potts, J (2015) Innovation Strangled by Red Tape. Institute of Public Affairs Submission into the Productivity Commission Inquiry into business set-up, transfer and closure. Available at: [http://ipa.org.au/portal/uploads/200215\\_Submission-DA-innovation\\_strangled\\_by\\_red\\_tape.pdf](http://ipa.org.au/portal/uploads/200215_Submission-DA-innovation_strangled_by_red_tape.pdf)

<sup>2</sup> Hogan, B. (2016) Where have all the entrepreneurs gone? Institute of Public Affairs Fact Sheet, 7 March 2016, Available at: [http://www.ipa.org.au/images/Where\\_Have\\_all\\_the\\_Entrepreneurs\\_Gone.pdf](http://www.ipa.org.au/images/Where_Have_all_the_Entrepreneurs_Gone.pdf)

While understanding the underlying economic drivers of this trend is a complex endeavour, one preventable explanatory factor, we propose, is the growing burden of red tape. This is because unnecessary and poor quality red tape are a barrier to small business entry. Government gets in the way of this natural market process by making it hard for small businesses to overcome burdensome red tape.

Australian businesses now operate in an institutional environment characterised by red tape. The Institute of Public Affairs found that throughout 2015 the Commonwealth government passed 6,453 pages of legislation. Those pages pile on top of the existing stock of legislation, which was 103,908 pages in November 2012.



**Figure 1:** New Pages of Commonwealth Legislation, 1901-2015, Source: Institute of Public Affairs.

However these numbers only include legislation at the Commonwealth level. Small businesses are also impacted by the state and local government red tape.

# How much does red tape cost Australia?

Recent Institute of Public Affairs research estimated the foregone economic output from red tape is at least \$176 billion every year.<sup>3</sup> That means if we moved towards a 'best practice' regulations as defined by the World Bank our country would be approximately \$176 billion richer.

To put this figure into perspective consider that the cost of red tape is the equivalent of \$19,000 for every household. Or, put another way, at 11 per cent of GDP red tape is our largest industry - more than mining (7 per cent), manufacturing (6 per cent), and agriculture (2 per cent).

This new measure of red tape is more than double than the Commonwealth government estimated in 2014. Their estimate, based on an audit of portfolios, focused on the compliance costs of red

tape and determined the annual cost to red tape at \$65 billion. However this \$65 billion only includes compliance costs such as the time spent filling out forms, duplicating reports, and pandering to government. It doesn't include all of the economic distortions that red tape brings, such as the lost entrepreneurship, declining international competitiveness and a general dampening of economic growth.

Our new estimate of the cost of red tape is the most comprehensive indication of the real cost of red tape on the Australian economy. Using a method pioneered in the US we are able to incorporate more broadly the impact of red tape, including the businesses that were never started, employees never hired, or good business decisions never made, due to the shackles of red tape.

<sup>3</sup> Novak, M. (2016) The \$176 Billion Tax on Our Prosperity, Institute of Public Affairs Occasional Paper May 2016, Available at: <http://ipa.org.au/portal/uploads/The-176-Billion-Tax-On-Our-Prosperity.pdf>

# Red tape hurts small business

There is substantial evidence that the impact of red tape falls hardest on small and medium sized business. For instance, a recent survey by the Australian Chamber for Commerce and Industry (ACCI) found approximately 47 per cent of small and medium businesses were prevented from making changes to grow their business by government regulation.<sup>4</sup>

Economists in the United States found that the cost of regulatory burden falls disproportionately hard on small businesses. Specifically, as of 2008 small firms faced regulatory costs 36 per cent higher than those faced by large firms. Small businesses in the manufacturing sector are the hardest hit - burdened with double the cost of their medium and large competitors within the same sector.<sup>5</sup>

One example of the major barriers facing businesses are licensing regimes. Searching the database of Australian licenses, permits and approvals quickly reveals over 30,000 obligations. Over 25,000 of those obligations are implemented and administered at the local government level.

One area in need of reform, and thus in need of advocacy, is occupational licensing. Occupational licensing is a restriction of the ability to enter a profession and work. The idea that the purpose of occupational licensing is to raise wages by inhibiting entry is as old as Adam Smith writing back in the 18th century. As the IPA's Professor Jason Potts wrote:

... occupational deregulation almost never occurs. Instead, the licensing of occupations is a continuously-expanding frontier, ever upgrading old trades and new services to the mantle of professional status, and always justified as in service of the public good.<sup>6</sup>

As the IPA's Mikayla Novak noted in the *Sydney Morning Herald* late last year, there are many problems with occupational licensing regimes:

[occupational licenses] effectively acts as a labour market barriers due to the usually hefty training requirements and fee obligations, disproportionately affecting low income earners, young people and immigrants who might find it more difficult to find the requisite cash and time to get licensed.

... [make it] more difficult for more people to find work than is presently the case, occupational licensing restrains the supply of service providers in the market.<sup>7</sup>

Put simply occupational licenses hurt small businesses the most because they are the least able to absorb the often heavy burdens of obtaining those licenses. This suggests many licensing regimes are regressive. Recent research by scholars at the Mercatus Centre in the United States confirms the regressive nature of entry restrictions such as occupational licensing. Scholars McLaughlin and Stanley found that the impact of entry restrictions into professions has a regressive effect. This means licenses can disproportionately impact those on lower incomes and may therefore perpetuate inequality.<sup>8</sup>

More broadly there is evidence that barriers to entry in markets, such as the licences and permits described above, can hamper the creation of new small firms and therefore act as a barrier to entrepreneurship.<sup>9</sup>

While occupational licensing represents one example of a raft of red tape problems, it is representative of the broader red tape problem weighing down on small business, and holding back our country.

# Conclusion

In this submission we have outlined Australia's red tape problem, and particularly how it relates to small business. Red tape costs the Australian economy at least \$176 billion every year.

Cutting the red tape on businesses ranges from zoning and planning restrictions, to the complexity of the tax system, to industrial relations law.

Only by removing unnecessary and burdensome rules and policies can we unleash small businesses to grow into medium businesses.

The advocacy role of the *Australian Small Business and Family Enterprise Ombudsman* should be centred firmly on cutting red tape, because only by cutting red tape can we unleash prosperity.

The Institute of Public Affairs is eager to meet with the Ombudsman to discuss Australia's red tape problem and how we can cut it to unleash prosperity.

<sup>4</sup> Australian Chamber for Commerce and Industry (2015) ACCI Annual Red Tape Survey, Available at: [https://www.acci.asn.au/sites/default/files/uploaded-content/field\\_f\\_content\\_file/acci-2015-national-red-tape-survey\\_final.pdf](https://www.acci.asn.au/sites/default/files/uploaded-content/field_f_content_file/acci-2015-national-red-tape-survey_final.pdf)

<sup>5</sup> Crain, N. V. and Crain, W. M. (2010) The Impact of Regulatory Costs on Small Firms. Small Business Australia Office of Advocacy, September 2010.

<sup>6</sup> Potts, J. (2009) Open Occupations - Why work should be free. *Economic Affairs*, 29(1), 71-76.

<sup>7</sup> Novak, M (2015) Occupational licensing hinders job creation and economic growth. *Sydney Morning Herald*, 18 September 2015, Available at: <http://www.smh.com.au/comment/occupational-licensing-hinders-job-creation-and-economic-growth-20150917-gjp7m7.html>

<sup>8</sup> McLaughlin, P and Stanley, L (2016) Regulation and Income Inequality: The Regressive Effects of Entry Regulations. Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, January 2016, Available at: <http://mercatus.org/publication/regulation-and-income-inequality-regressive-effects-entry-regulations-0>

<sup>9</sup> Klapper, L., Laeven, L., & Rajan, R. (2006). Entry regulation as a barrier to entrepreneurship. *Journal of Financial Economics*, 82(3), 591-629.



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