National Audit Office

Report
by the Comptroller
and Auditor General

Department for Business, Innovation & Skills
and Cabinet Office

The Business Impact Target: cutting the cost of regulation

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Key facts

-£10bn

target reduction in regulatory costs to business over the course of this Parliament

-£0.9bn

government estimate of reduced net cost to business of regulatory decisions made so far this Parliament that **do** qualify as part of its target

+£8.3bn

government estimate of increased net cost to business of regulatory decisions made so far this Parliament that **do not** qualify as part of its target

£10 billion	estimate by the previous government of reduction in costs to business achieved during the 2010–2015 Parliament
90%	of total expected reductions in costs during 2010–2015 Parliament were achieved through only 10 regulatory decisions
2	in scope regulatory decisions made during the 2010–2015 Parliament that have been evaluated after implementation and independently verified by June 2016
51%	of businesses think the level of regulation in the UK is an obstacle to success
46%	of small businesses identified tax administration, which is not within the scope of the government's Business Impact Target, as a burdensome area of compliance
9	departmental Better Regulation Units (out of 14) are not very or not at all confident that they will meet their deregulation budget

Summary

1 Regulation has many purposes, including protecting consumers and the environment, promoting competition and supporting economic growth. However, businesses incur significant costs in complying with regulations. This can act as a barrier to competition in markets and reduce productivity. Our 2014 survey of business perceptions, published jointly with the Department for Business, Innovation & Skills, found that 51% of businesses saw the level of regulation in the UK as an obstacle to business success. The government aims to reduce the cost of regulation for businesses, the voluntary sector and community bodies in order to free up business resources and boost productivity and growth. Since the late 1980s, successive governments have had policies to improve the quality of regulation and reduce its impact on business. By international standards, regulatory costs in the UK are low.

2 The previous government estimated that it reduced regulatory costs for businesses by £10 billion during the 2010–2015 Parliament. This is equivalent to an average annual saving of around £400 for each UK business. Over 90% of this reduction was due to 10 changes, including changing the inflation index used to increase pension benefits, reducing audit requirements for small companies, and streamlining the guidance relating to contaminated land.

3 The Small Business, Enterprise and Employment Act 2015 requires the government to set a target for the economic impact on business of regulatory decisions made during the course of each Parliament. In its 2015 manifesto, the Conservative Party committed to reducing regulatory costs by £10 billion between 2015 and 2020. This commitment was formalised in the Business Impact Target (the Target) in March 2016, with the aim of encouraging public bodies to minimise the costs that their regulatory decisions place on businesses.

4 The Better Regulation Executive (BRE), a joint Department for Business, Innovation & Skills and Cabinet Office unit, is responsible for developing and implementing a framework for achieving the Target. Departments and regulators are responsible for making regulatory decisions to achieve the Target. At the policy planning stage, HM Treasury guidance requires departments to complete impact assessments that contain estimates of the annual costs and benefits of the preferred policy option. The BRE provides additional guidance on how to calculate costs and benefits to business. The Regulatory Policy Committee (RPC), an advisory non-departmental public body, validates departments' estimates of costs and benefits to business.

5 In this report, we examine:

- the scope of the Target and how it relates to business experience (Part Two);
- the BRE's approach to achieving the Target (Part Three); and
- the robustness of systems to estimate and evaluate the impacts of regulatory decisions (Part Four).

Key findings

The scale and scope of the Business Impact Target

6 **The government does not know how much cost businesses incur as a result of its existing regulations.** This means that it cannot know how ambitious its target for reducing regulatory costs is. Many departments have only a partial understanding of how the existing 'stock' of regulations for which they and regulators are responsible affects businesses, and of where burdens could most easily be reduced. While some departments are working to improve analysis of their stocks of regulation, five of the 14 departments with regulatory responsibility within the scope of the Target told us they have no plans to quantify existing regulations (paragraphs 3.4 and 3.5).

7 **The Target does not and is not designed to reflect all administrative and regulatory costs to business.** As well as measures within the scope of the Target, businesses face costs from factors including:

- tax administration, covered by the HM Revenue & Customs programme to reduce the annual cost of tax administration by £400 million by the end of this Parliament. Nearly half (46%) of small businesses said that tax administration was a burdensome area of compliance;
- European Union (EU) regulation, covered by the European Commission's REFIT programme. Of the 951 regulations validated by the RPC during the last Parliament, 297 (31%) originated in the EU; and
- fees, charges, self-regulation and co-regulation.

There is no overall picture of how these costs affect businesses. Government statements do not always make clear the limitations in the Target's scope (paragraphs 2.3, 2.4 and 2.7 to 2.11).

8 The £8.3 billion of expected costs imposed on business so far this Parliament that are not included in the scope of the Target greatly exceed the £0.9 billion that are. Almost half (46%) of the 951 regulatory decisions made during the last Parliament did not count towards estimated savings to business of £10 billion. For this Parliament, ministers have decided to exclude several important recent regulatory provisions from the Target, notably the National Living Wage, which is expected to add £4.1 billion of costs to business. The government announced the introduction of the National Living Wage at summer Budget 2015, along with changes to business taxation. Ministers decided that, because the impact of the National Living Wage on businesses was offset by reductions in corporation tax and National Insurance, it should be excluded from the Target. However, we consider that this approach leaves the government open to claims of 'cherry-picking' the measures that it includes (paragraphs 2.5 and 2.6).

Achieving the Business Impact Target

9 By agreeing individual deregulatory budgets with departments, the BRE has encouraged departments to take an active role in reducing regulatory costs. The agreed individual budgets total to £15.8 billion, much more than the overall Target. This is to provide greater challenge to departments, while recognising that some departments may fall short of their budgets. Officials said that individual budgets have raised the profile of regulatory issues within their departments. However, some departments told us that their budgets were unrealistic because many of the easier options for reducing regulatory costs have already been taken. Nine of the 14 departmental Better Regulation Units involved were not very or not at all confident that they would be able to meet their budgets. Three departments have not yet agreed their budgets (paragraphs 3.3, 3.6 and 3.7).

10 The government does not ensure the wider societal costs and benefits of regulation are adequately considered. Businesses are concerned about the cost of regulation, but some stakeholders have raised concerns that deregulation could have harmful wider effects. Seven of the 14 departments involved told us that there were conflicts between deregulation and their overall policy objectives. Departments are expected to consider potential wider costs and benefits when making regulatory decisions, but the RPC found that departments did so rigorously in only a third of the impact assessments it examined in 2014. The RPC is unable to rate an impact assessment as unfit for purpose on the grounds of inadequate consideration of wider impacts (paragraphs 3.15 to 3.18).

11 The BRE recently launched a review of the efficiency of the better regulation system, including the costs to departments and regulators of complying with its processes. Some departments commented on the level of bureaucracy associated with the BRE's rules, and told us that their complexity diverts resources away from genuine deregulatory activity. Since 2010, the BRE has not assessed how impact assessments are used to make regulatory decisions, or whether they result in better policymaking. We estimate that departments' Better Regulation Units cost £2.3 million per year and the BRE and RPC together cost £4.1 million in 2015-16. These estimates do not include costs incurred by departmental policy teams or regulators (paragraphs 3.19 to 3.22).

Estimating and evaluating impacts

12 **There are known weaknesses in the government's measure of regulatory costs, which could significantly reduce its effectiveness in driving reductions in cost.** Businesses and departments often do not understand the measure or the complex rules that determine which costs and benefits count towards it. The measure draws a distinction between direct and indirect impacts that has only partial grounding in business experience or economic principles. As a result, the measure does not sufficiently support policymakers to reduce costs on businesses (paragraphs 4.2 to 4.6).

13 **The government and the RPC have established robust processes to ensure that the method for calculating expected business costs and benefits is applied correctly.** We examined 10 recent impact assessments accompanying regulatory decisions, and found that all of them included clear breakdowns of expected costs and benefits to business. The RPC's approach to validating the expected impacts of regulatory changes is thorough and comprehensive, and has increased the transparency of impact assessments (paragraphs 4.7 to 4.10).

14 **Although HM Treasury guidance says that departments should monitor the ongoing impact of their regulatory decisions, they rarely do so.** This means that departments could miss opportunities to adapt policies in ways that would help businesses. Even where departments do monitor actual impacts on business, the BRE does not report the results of this monitoring or update progress recorded towards the Target as new evidence emerges. The BRE told us that it thought doing so would allow departments to update estimates selectively to increase their chances of meeting their budgets (paragraphs 4.11 to 4.13).

15 **Lack of evaluation means that the government cannot know the real impact of its efforts on business and does not learn lessons from previous interventions.** Since 2010, the BRE has advised departments to carry out post-implementation reviews to assess whether expected costs and benefits were realised. According to BRE guidance, departments should review regulatory decisions within five years of implementation. Of the 83 in-scope regulatory decisions made by departments in 2011, only two reviews have been completed and independently assessed, while a further five have been scheduled. Departments frequently fail to plan for evaluation when making regulatory decisions; of the 10 impact assessments from this Parliament that we examined, none included plans for how departments would carry out post-implementation reviews (paragraphs 4.14 and 4.15).

Conclusion on value for money

16 Within its relatively narrow constraints, the BRE has done good work in raising the profile, across Whitehall, of regulatory costs imposed on business. But the government's measure excludes over £8 billion in costs to businesses during this Parliament so far, many times greater than the £0.9 billion of savings it includes. Limitations in the approach means the scope of the Target is open to manipulation and may not reflect a realistic business-centred view of regulatory costs. Moreover, departments do not do enough to appraise the wider impacts of their decisions, or to evaluate their effects. This harms the credibility of claimed savings and reduces opportunities to learn from past experience. Until robust evidence to show that the government's efforts are improving regulation overall is available, the government will not be in a position to demonstrate that its efforts are providing value for money.

Recommendations

17 Departments and regulators, with the support of the BRE, should:

a **Improve their understanding of the effects of existing regulations on businesses.** Departments should know the costs and benefits of their existing regulations, and the BRE should do more to help departments to share different approaches to measuring their impacts. This would help departments and regulators to prioritise which regulations to amend or remove and provide a better evidence base for setting future departmental budgets.

b **Improve monitoring and evaluation of the impacts of key regulatory decisions.** The BRE should develop its guidance to encourage departments to plan evaluations at the policy development stage and monitor ongoing impacts on business and wider society. The government should expand the RPC's role to assessing whether impact assessments contain adequate monitoring and evaluation plans.

c **Demonstrate detailed consideration of the wider social impacts of key regulatory decisions in impact assessments.** This would help the government to make trade-offs between deregulation and other policy objectives. The RPC should be enabled to declare an impact assessment unfit for purpose on the grounds of insufficient consideration of such wider impacts.

18 The BRE and departments such as HM Revenue & Customs that work closely with businesses, should:

d **Work together to ensure that the government's approach to deregulation reflects businesses' overall experience.** They should take a strategic approach to increase understanding of the interactions between different types of burden, and enable better prioritisation of the government's efforts. Building on its previous reviews, the BRE should commission an independent review of its measure of regulatory costs, assessing whether an alternative approach could provide a better breakdown of different types of impact on businesses. In public statements, the government should make clear that the current Target does not include the full range of regulatory decisions that affect businesses.

19 The BRE should:

e **As currently planned, review the total costs to departments and regulators of its approach to reducing regulatory costs.** The BRE cannot currently provide assurance that its framework is making best use of departments' and regulators' limited resources. Given that most regulatory decisions have only a minor effect on businesses, the government could substantially increase the impact of its work by focusing its efforts on the most important decisions.

f **Evaluate the overall performance of the Target in achieving the government's objectives once sufficient evidence is available.** This would inform decisions about how the government's approach to reducing the costs of regulation should evolve, and make it easier for future governments to set appropriate targets.