

CHAPTER 4

The Drag on Productivity from Excessive Regulation

By Laura Jones

No discussion about productivity would be complete without considering the drag that excessive regulating has on productivity and economic growth. *Excessive regulation*, often colloquially referred to as red tape, stands in stark contrast to *justified regulation* where social benefits outweigh social costs.

Justified regulation serves a clear purpose, delivers reasonable benefits relative to its costs, and is administered efficiently and fairly. It includes government laws, regulations, rules, and policies that support an efficient and effective marketplace and that provide citizens and businesses with intellectual property protections and other protections that they need. Many government rules (and the administration that supports them) fall into this category.

Excessive regulation is the dark side of regulating—government rules and processes run amok. It refers to rules, policies, and poor government service that do little or nothing to serve the public interest, while creating financial costs and frustration for producers and consumers alike. Sometimes the excess is the government rule or regulation itself. Other times it is the way the government rules are administered. Often it is a combination of both.

How big a drag is excessive regulation on productivity?

Regulations that deliver little or no net social value clearly undermine productivity, because the time and money spent on understanding and accommodating them could be put to better use in any number of ways that would

Figure 1: The Effect of Excessive Regulations on the Productivity and Growth of Small- and Medium-Sized Enterprises (% response, Canada and the US)



Sources: CFIB (2012), *Survey on Regulation and Paper Burden*, n=8,562; and Ipsos Reid (2012), *Survey on Regulation and Paper Burden in the United States*, n=1,535.

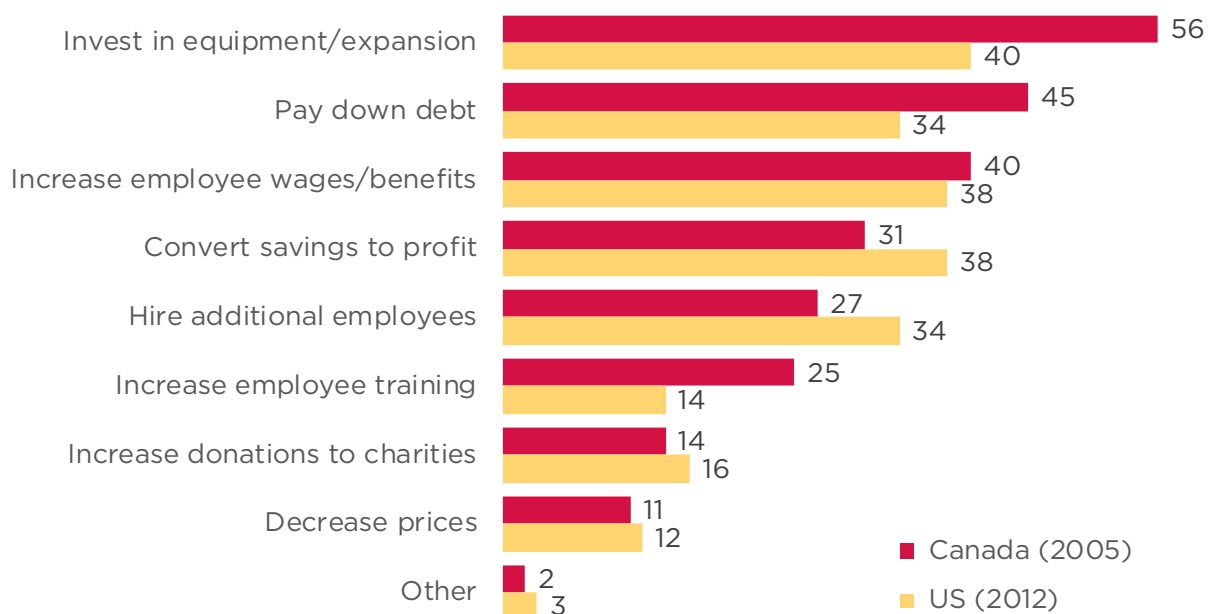
allow output to increase immediately or in the future. However, quantifying the specific impact of regulation on productivity is challenging because regulatory measurement, particularly at the macro level, is still in its infancy.

One Canadian attempt to quantify the cost of regulation and to differentiate between justified regulation and red tape suggests that the drag on productivity is substantial. Specifically, the Canadian Federation of Independent Business (CFIB) uses a survey-based approach to estimate the cost of regulation. Its latest update finds that Canadian businesses of all sizes spend \$36 billion a year on regulation (Wong, 2018).

CFIB's survey asks business owners how much of the annual cost of regulation could be reduced without adversely affecting the health, safety, and environmental outcomes that regulation seeks to achieve. In other words, how much of the cost of regulation could more accurately be called red tape? The answer: roughly 30 percent or \$10 billion a year. Put in different terms, eliminating red tape could free up the equivalent of 200 million hours of business owners' time or the equivalent of 103,000 full time jobs (Jones, Gormanns, and Wong, 2013).

In the CFIB surveys, roughly seven out of ten Canadian small business owners agree that excessive regulation significantly reduces productivity, while closer to six out of ten US small businesses agreed with the

Figure 2: How Businesses Would Use the Savings If Their Regulatory Costs Were Reduced (% response, Canada and the US)



Sources: CFIB (2005), *Survey on Regulation and Paper Burden*, n=7,391; and Ipsos Reid (2012), *Survey on Regulation and Paper Burden in the United States*, n=1,535.

same statement, suggesting that it is a big issue for small- and medium-sized firms in both countries, but it is a bigger issue for Canadian firms (see figure 1) (Jones, Gormanns, and Wong, 2013). A substantial fraction of businesses in both countries also agree that excessive regulation discourages them from growing their businesses, and almost half say that if they had known the burden of regulation, they might not have gone into business. This finding suggests that some unknown number of small firms never started because their potential owners worried about the burden of regulation.

When asked how the savings from regulatory reduction would be used, investing in new equipment/expansion, paying down debt, and increasing employee wages/benefits were the top answers for small business owners. Hiring additional employees and increasing employee training were also on the list (see figure 2). While more study is needed, these data suggest that a reduction in red tape would have immediate and future productivity benefits. Fewer resources dedicated to complying with excessive rules could free up money to increase wages and make investments in new machinery and employee training, which are key to future productivity gains.

Regulation and economic growth

A recent review of academic research that uses cross-country comparisons to evaluate the impact of economic regulation on growth finds that higher levels of economic regulation are consistently associated with lower rates of economic growth per capita, as well as lower industry, region, and firm productivity (Broughel and Hahn, 2020). The review points out that only a few studies produce a simple estimate of the cumulative or marginal effect of regulation on growth, although those that do suggest it is significant. For example, one study of 135 countries between 1993 and 2002 found that countries with a more business-friendly regulatory environment grew faster than those with more burdensome regulatory environments—improving from the worst quartile of business regulation to the best can increase annual growth by 2.3 percentage points (Djankov, McLiesh, and Ramalho, 2006).¹¹ One challenge to research in this area is the limited data available. Most studies can be traced back to three data sources—one that focuses on the number of steps and time it takes to start a business, one that is based on a questionnaire filled out by OECD member countries, and one that evaluates restrictions countries impose on dismissing workers and the procedures for hiring workers on temporary contracts (Broughel and Hahn, 2020).

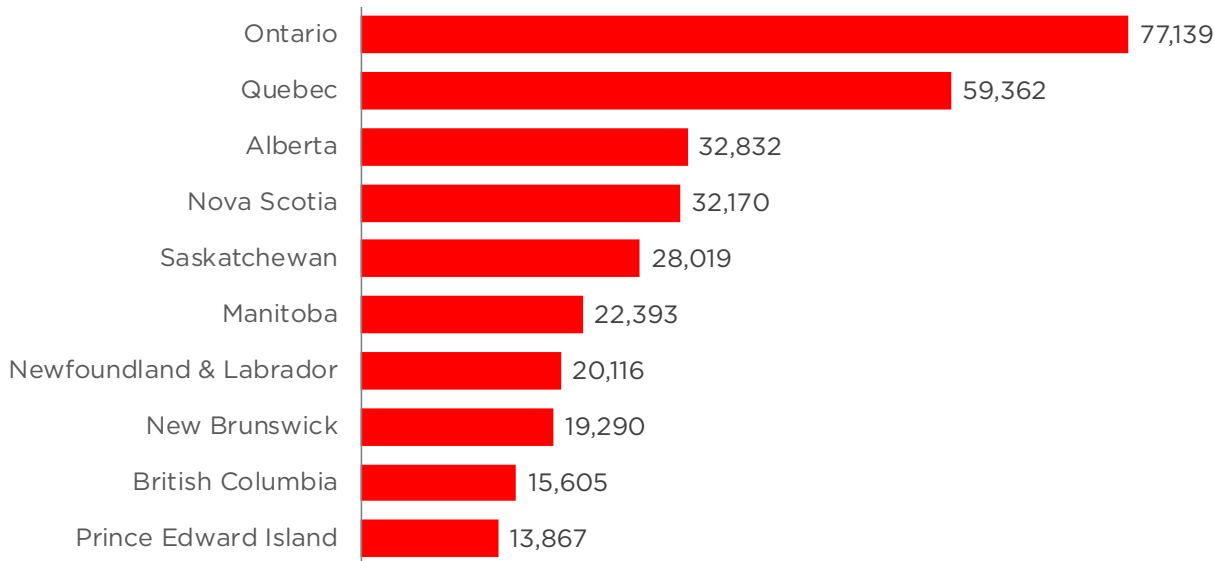
An interesting study using data specific to the US provides further evidence that red tape undermines productivity and living standards. Coffey, McLaughlin and Pietro (2016) conclude that if US regulation had stayed at 1980 levels, GDP would have been \$4 trillion dollars higher by 2012, translating to a per capita income gain of US\$13,000.

Inadequate scrutiny of regulatory costs

Academic studies aside, regulatory costs do not get anywhere near the real-world scrutiny they deserve. The government's annual fiscal budget is an institutionalized moment each year where spending choices and taxes are subjected to reasonably rigorous review. Fiscal excesses or spending scandals are seen as wasteful and disrespectful to taxpayers. But what of regulatory excesses? There is no annual regulatory budget exercise to parallel fiscal budgets and no culture around measuring and challenging the cumulative regulatory burden we carry as a society, which creates a drag on the growth of productivity and living standards. Changing this situa-

¹¹ Given that productivity is a key driver of economic growth, the finding supports an important linkage between reducing red tape and improving productivity growth.

Figure 3: Number of Regulation Restrictions for Canada's Provinces



Source: McLaughlin, Atherley, and Strosko (2018).

tion starts with better regulatory data collection and reporting, something Canadian governments have recently shown more interest in.¹²

Regulatory measurement in Canada

Several provinces, including British Columbia and more recently Manitoba, have shown leadership in tracking efforts to reduce excessive regulation using an aggregate measure called “regulatory requirements,” which captures the individual actions or steps that businesses and citizens must take to comply with government rules. The Mercatus Center at George Mason University uses a similar approach to track regulatory activity in the United States and has recently published data that can be used to compare provinces (McLaughlin, Strosko, and Jones, 2019).

¹² In 2001 the British Columbia government started publishing government-wide regulatory counts. Since then, other provinces have introduced measurements, with varying degrees of comprehensiveness and consistency. There is no federal estimate of the cost or quantity of regulation that is comprehensive for Canada. For more on regulatory measurement in Canada, see Canadian Federation of Independent Business (2020).

The data show a wide variation in regulatory loads at the provincial level using “regulatory restrictions” as an indicator. Regulatory restrictions include prohibitions and obligations found in regulatory text. It excludes restrictions found in legislation and regulatory guidance documents, which are included in some other provincial regulatory requirement counts, making the Mercatus data less comprehensive. Nevertheless, the data can be used to get a sense of comparison between provinces (see figure 3). While differences in sectors and size can explain some of these differences, such as PEI having fewer regulatory restrictions than Ontario, the data support the idea that less regulation is possible without adversely affecting outcomes. A case in point is British Columbia, which has a fraction—one fifth—of the restrictions of Ontario with similarly high levels of safety and environmental protection.

Operationalizing red tape reduction: The British Columbia model

British Columbia has been a leader in regulatory measurement and transparency since 2001 when it was the first province to regularly report a measure of the regulatory burden and set a reduction target.¹³ It used a methodology similar to Mercatus but counted government rules from a broader array of instruments, including government policies and forms. Its original baseline in 2001 was 330,812 regulatory requirements, and it currently sits at 166,919, representing an almost 50 percent reduction (British Columbia, 2018). British Columbia’s experience further suggests that a serious overall reduction in regulatory load is possible without sacrificing the legitimate objectives of regulation, as health, safety, and environmental outcomes have remained high in the province.

Three important factors behind British Columbia’s success at reducing regulatory requirements include: strong political leadership, a simple but comprehensive measure that was regularly reported, and setting a concrete target for reduction that served as a form of regulatory cap or budget for regulators.¹⁴

Essentially the government went on a regulatory diet, making the commitment to reduce the burden of regulation by one-third in three years (between 2001 and 2004). It then developed a measure that was regularly reported at cabinet meetings and publicly. To meet the reduc-

¹³ BC’s reforms have been a model or provided inspiration for many provinces and states including Manitoba, Alberta, Ontario and Kentucky and Virginia.

¹⁴ For a detailed description of British Columbia’s reforms, see Jones (2015).

tion target, the province established a policy of eliminating two regulatory requirements for every new one added.

Initially the government intended for the initiative to last three years. However, once the one-third reduction was achieved in 2004, small businesses asked the government to maintain the reduction with a new policy of requiring that one regulatory requirement be eliminated for every new one introduced. The policy has been extended several times and remains in place today. Interestingly, the number of regulatory restrictions has continued to drift downward without a requirement for it to do so, which suggests that there has been a change in culture around regulating.

British Columbia's regulatory reforms were a departure from the more typical approaches that other jurisdictions use, which include a focus on requiring or enhancing Regulatory Impact Assessments (RIA) or reforms that ask stakeholders to identify specific issues and irritants that need to be addressed. These latter approaches may slow the growth of regulation but do not appear effective at eliminating excessive regulation.

Did British Columbia's reduction in regulation affect productivity, economic growth, and living standards? This question has not been answered definitively, and it is made harder to answer because regulatory reform was part of a broader package of economic reforms happening at the same time, which included a significant tax cut. What we can definitively say is that BC's economic performance improved markedly after 2001. The province went from being one of the worst performing in the country to one of the best. BC's real GDP growth was lower than Canada's as a whole in six of the nine years between 1992 and 2000, but grew faster than Canada's every year between 2002 and 2008 (Finlayson, 2009).

The future of regulatory policy: unleashing productivity gains by reducing red tape?

How we think about regulation may be changing for the better. Not only is there more recognition that regulating without constraint is a drag on productivity and economic growth, but there is less tolerance on the part of millennials for outdated processes involving fax machines and waiting in line for things that could be done online, and there are more regulatory reform initiatives rooted in measurement. However, there are reasons for pessimism, too. For example, the regulatory processes around big projects have expanded. Specifically, timeframes for federal project reviews of energy infrastructure have lengthened and are longer than would be expected for similar projects in jurisdictions with comparable standards outside of Canada (Drance, Cameron, and Hutton, 2019). Clearly the

additional process adds expense to these projects. Exactly what additional benefit is being delivered is much less clear.

Recent events may accelerate the desire to reduce unnecessary regulation as COVID-19 will leave a trail of lower growth and larger fiscal deficits in its wake. Governments on the hunt for low-cost ways to increase productivity and stimulate the economy will find reducing unnecessary regulation to be a powerful tool. Leveraging this tool requires political leadership, a commitment to measurement, and a change in mindset that recognizes that not all regulation is the same. Justified regulation makes sense; excessive regulation is not worth its cost.

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About the Author



Laura Jones is Chief Strategic Officer and Executive Vice-President of the Canadian Federation of Independent Business (CFIB), a non-profit association that advocates for 110,000 independent businesses across Canada. She is responsible for CFIB's legislative, communications, research, and marketing functions.

Since joining CFIB in 2003, Ms. Jones has spearheaded several high-profile campaigns on behalf of small businesses, including creating CFIB's annual Red Tape Awareness WeekTM and Small Business Every Day Campaign. She has authored a number of studies on regulation, including papers for the Organisation of Economic Co-operation and Development (OECD), the Mercatus Centre, and CFIB.

Ms. Jones has been providing advice to Canadian governments on effective regulatory reform for more than a decade, having served on several federal and provincial regulatory committees. Currently, she serves as Chair of the federal External Advisory Committee on Regulatory Competitiveness. She is currently on the board of the Macdonald-Laurier Institute and CFIB.

Ms. Jones received her B.A. in Economics from Mount Holyoke College in Massachusetts, and her M.A. in Economics from Simon Fraser University. She and her husband live in Vancouver with their three spirited children.