



Part 3

3.3

Advocacy Tool 2

How to formulate enabling environment reforms

Section 3.3: Advocacy Tools

Costing proposals



Purpose

Policies and regulations have economic impacts – positive and negative. They impact on different groups - *in monetary terms* – in different ways. This tool will assist EOs in incorporating the economic impact on business into its proposal making processes.



How to use this tool

This Assessment Tool is designed for use by EOs. It is best used as a guide for employers and enterprise development specialists who will facilitate the assessment process with the EO and among other actors.

Step 1: How can an EO use a Cost Benefit Analysis?

Step 2: Identifying costs

Step 3: Identify benefits

Step 4: How can EOs utilize a CBA



Step 1: How can an EO use a Cost Benefit Analysis?

1.1 What is a Cost Benefit Analysis?

Cost benefit analysis¹ (CBA) is one approach to costing a proposed policy or regulation. A cost benefit analysis involves, whether explicitly or implicitly, weighing the total expected costs against the total expected benefits of one or more actions, in order to choose the best or most profitable option. CBA is typically used by governments to evaluate the desirability of a given intervention. However, a CBA will help Employers' Organizations make explicit the economic assumptions that might otherwise remain implicit or overlooked and which are useful for convincing policy-makers that the benefits justify the activity.

Even where the Employers' Organization is able to quantify relatively few costs (or benefits) using the CBA systematic approach to try to ensure that all benefits and costs have been identified and assessed will help to improve the quality of advice to decision-makers. Where costs have not been quantified, it is often possible to discuss them in qualitative terms, drawing some conclusions about their relative importance.

Some principles of CBA:

- The cost benefit analysis for a proposed change in policy or regulation should be proportionate to the likely impact, but should be rigorous enough to inform decision-making.

¹ Business Advocacy Network: *Analysing costs & benefits*.

- The analysis needs to compare the positions *with* and *without* the change,
- The analysis should only consider the *additional* benefits and *additional* costs, remembering that not changing in the way proposed may force other changes with associated costs.

Step 2: Identifying costs

Estimating monetary values can be difficult, particularly where people's time is involved, so estimates need to be rooted in evidence. Identifying an exact cost – particularly on a policy – can be difficult and is in some cases impossible. The EO may therefore give in its positions in ranges rather than implying total accuracy.

Costs may be a one off or imposed as a continuing burden on businesses: they may be related to the policy or they may be related to implementation. The separation of direct (policy) and indirect costs (implementation) is important.²

Policy costs are those that are directly attributable to the policy goal (for example, an import duty, or the cost of a license, or the costs necessary to meet the policy objective), while implementation costs are those associated with understanding the requirements, keeping records, or demonstrating compliance.

When evaluating the cost that regulation imposes, the EO should consider both the “direct” and “indirect” costs of regulation.

2.1 Direct Costs

The direct costs of regulating are those that businesses face as a direct result of complying with the regulations and the cost to government of administering and enforcing the regulations. These are usually the immediate costs of the policy or regulation. They include the costs of:

- Buying new equipment needed to comply with regulations;
- investing in existing equipment;
- employing additional staff to work on regulatory compliance;
- employing consultants or other sources of expertise to help with regulatory compliance;
- changes in production processes made necessary by regulations;
- other increases in the costs of producing goods; and
- cost of getting licences – these will involve estimating the fees plus administrative costs;
- cost of extra legal, accountancy or other consultancy advice.

2.2 Indirect costs

The indirect costs can be of a more subtle nature but not necessarily be any less than direct costs. They include the costs of:

- Labour (familiarization with new legislation, training, new working practices, time spent taking inspectors around the enterprise, etc.);
- specific training, for example on new equipment or procedures that have been mandated by a regulatory change;

² History of Benefit-Cost Analysis: Proceedings of the 2006 Cost Benefit Conference.

- collecting information and providing proof of compliance labour costs, plus the cost of new equipment (e.g., computers or software) required to do this;
- changing working practices.

The EO can identify the costs by thinking about the aim of the proposal and what enterprises will be required to do. Many of the effects are “hidden”, or at least are difficult to identify when a regulation is being considered. The EO needs to ascertain who will be affected by a regulation and how.

MEASURING IMPLEMENTATION:

Commitment to reform regulations covering freight transport: using specific examples of the cost and time to ship freight from country X to country Y through country X’s principal port. The indicators used to measure progress could include:

- ✓ Changes/simplifications in custom regulations;
- ✓ infrastructure improvements;
- ✓ deregulated transport options;
- ✓ reduced bureaucratic steps.
- ✓ Specific costs could be then extrapolated from each of these variables.³

Finally, it may be useful to outline the potential implications if the regulation didn’t exist. For example it may be possible to present the regulatory change as a drag on enterprise competitiveness that if removed would have improved some of the following variables: *cash flow*, *investment in R&D*, *market expansion*, and potentially the ability to expand operations. This would have positive consequences in other areas of government, namely revenue collection.

The EO will also need to quantify the costs, some of which will be easier to estimate than others. The chart below outlines how this might be achieved.

ESTIMATING COSTS:

Cost	Time taken	Hourly cost	Frequency (per year)	Enterprises affected	Total cost
Reporting to government	2 hours	\$50	Twice	20,000	$2 \times \$50 \times 2 \times 20,000 = \4 million per year.
Recalibrating machinery to maintain emissions performance	3 hours	\$100	One off	20,000	$3 \times \$100 \times 20,000 = \6 million per year

Figure 1⁴

When identifying costs (or benefits) it is important to count them only once (e.g. one enterprise incurs a cost, which it then passes on to a customer through higher prices) – this should only be counted once in the cost benefit analysis.

³ World Bank: *World Development Report*, 2005.

⁴ OECD: *Introductory Handbook for Undertaking Regulatory Impact Analysis (RIA)*, 2008.

The EO should also spell out assumptions it has made in relation to a cost (e.g. administrative work required to maintain compliance with regulation Y would entail 45 man hours to be carried out by administrative function, with current market rates at \$“X” per hour). This would need to be supplemented by approximately six professional hours and these would be outsourced to a professional enterprise (i.e. an accountancy enterprise) with market rates of \$“X” per hour.

2.3 Using discounted cash flow principles

Costs and benefits, whether economic, social or environmental, must be measured in monetary terms, and that needs to be at ‘present values’ to eliminate the impact of inflation. This can be done by utilising a technique, known as discounted cash flow (DCF), which values future cash flows as “how much money would have to be invested currently, at a given rate of return, to yield the cash flow in future”.⁵

For example, let’s say someone was asked to choose between receiving \$100 today and receiving \$100 in a year. Chances are they would take the money today, knowing that they could invest that \$100 now and have more than \$100 in a year’s time. If that thinking is turned on its head, you are saying that the amount that you’d have in one year is worth \$100 dollars today - or the discounted value is \$100.⁶

Third, discounting is often used to account for price inflation. That is, a dollar is able to buy less in the future than it buys today because of price inflation. Thus, its future value is less than today’s value.

What discount period should be used for the policy’s costs? It depends on the policy proposal, but a ten-year period is typical. If the costs or benefits are likely to appear well into the future you might want to consider a longer timescale. However, the EO should not deliberately pick a very long period in an attempt to get the answer that it wants.

DCFs are an invaluable but complex tool to estimate real monetary values. *Should an EO invest time in this process?*

It should certainly take on board the basic principles of discounted cash flow if a constraint they wish to change has monetary values that can be estimated. This does not have to be accurate in the sense a enterprise would use a DCF (this in any case would be practically impossible in terms of a policy) but it should be factored into the overall claim.

In cases though it may be worth investing in a deep DCF analysis if the constraint, policy or regulation that the EO wants changed has major monetary implications for enterprises over time (e.g. building major piece of infrastructure).

⁵ International Federation of Accountants: *Project Appraisal Using Discounted Cash Flow*, 2007.

⁶ Damodaran, Aswath (1996). *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset*. New York

EO EXAMPLE: COSTING REGULATION

The Confederation of British Industry (CBI) used the government's regulatory impact assessments, to estimate the cost of employment regulation for the period April 1998 to June 2009. They calculated the cost of each regulatory measure by taking the one-off initial cost of each regulation and adding the yearly recurring cost, uprated for inflation, based on the average increase in the Retail Price Index (RPI) for each year. The only exception was the cost of the national minimum wage each year, which was not indexed as regular uprating applies. Using this method of calculation, the total cost of employment regulation to the UK economy for the period 1998-2009 is £72,760m.

The CBI also estimated how many full-time jobs paid at average earnings this cost equates to over the period 1998-2009. To calculate this they took the mean average earnings of all full-time employees – including overtime and employer National Insurance Contributions – for the period, based on Annual Survey of Hours and Earnings data. They then divided the total cost of employment regulation by this total. This gave a figure of 215,090 jobs a year over the period.

To spell out the case they, included enterprises and the impact of legislation on individual enterprises. For example, a major retailer estimated that the work of assessing and revising all its HR policies and procedures to ensure compliance with just one new set of regulations took the equivalent of four person-years, with all the costs and diversion of senior staff from other business activities that entailed.

The CBI have used the research to develop a policy message. All future legislation should be tested by the question: how will this help create sustainable jobs?

http://www.siemens.co.uk/pool/news_press/jobs_for_the_future.pdf

2.4 Analysing costs of reduced Competition

Some regulations can reduce the amount of competition in markets. This is a particularly important cost impact. Regulation can reduce competition by:⁷

- making it more difficult for new competitors to enter the market, by creating regulatory requirements that are difficult for them to meet;
- prevent firms competing strongly – for example by setting rules that reduce price competition or restrict advertising;
- by creating a negative impression of a highly regulated market in which it is difficult to do business profitably.

The OECD has developed a “Competition Checklist”. It is designed to function as a screening test for the impact of regulations on competition. It is based on three simple questions, which ask about the impact of the proposal on the number of firms in the market and their ability and incentives to compete. These are the major factors influencing the intensity of competition. Under each of the three questions is a list of commonly found regulatory restrictions that would have the particular anti-competitive impact (this can be utilized at: <http://www.oecd.org/dataoecd/32/19/42228385.pdf>)

⁷ Introductory Handbook for Undertaking Regulatory Impact Analysis (RIA) 2008.

CHECKLIST COMPETITION: Will the regulation...

Grant exclusive rights to one entity to provide goods or services	GREEN	AMBER	RED
Establish a license, permit or authorisation process as a requirement of operation	GREEN	AMBER	RED
Limit the ability of some types of enterprises to provide a good or service	GREEN	AMBER	RED
Significantly raise the cost of entry or exit by a enterprises	GREEN	AMBER	RED
Creates a geographical barrier to the ability of companies to supply goods or services, invest capital or supply labour	GREEN	AMBER	RED
Control or substantially influences the prices for goods or services	GREEN	AMBER	RED
Limit freedom of enterprises to advertise or market their goods or services	GREEN	AMBER	RED
Set standards for product quality that provide an advantage to some enterprises over others or that are above the level that many well-informed customers would choose	GREEN	AMBER	RED
Significantly raises costs of production for some enterprises relative to others (especially by treating incumbents differently from new entrants)	GREEN	AMBER	RED
Requires or encourages information on supplier outputs, prices, sales or costs to be published	GREEN	AMBER	RED
Exempts the activity of a particular industry or group of enterprises from the operation of general competition law	GREEN	AMBER	RED
Reduces mobility of customers between suppliers of goods or services by increasing the explicit or implicit costs of changing suppliers	GREEN	AMBER	RED

2.5 Identify impact on sectors and firm size

The EO needs to identify where the burden is likely to fall most heavily.

- *What are enterprises being asked to do and when?*
- *Will some sectors be more affected than others?*
- *Will the change impact heavily on women-owned enterprises or on sectors in which women workers are dominant?*
- *Will the change impact heavily on a growing sector of the economy?*

Similarly with enterprises, larger enterprises are usually more able to adapt to changes and have the capacity to absorb changes and costs than SMEs. Placing the issue through the lens of its impact on an SME can be an effective advocacy strategy as can utilising an SME in a cost benefit analysis example.

Step 3: Identify benefits

The first step is to identify the benefits of the EOs proposal. In cases this can be direct and easily identifiable. For example, a new goods tax could have crippling effects on the retail sector but it also impacts on consumers directly. In the EOs proposal against the tax it can catalogue the impact on the retail sector but also the impact on the consumer and detail how much extra in dollar terms per year the government will take out of their pockets (and the economy).

But benefits do not all accrue at once and are more often received over time. EO's can identify the benefits by thinking about the aim of the proposal and the risks being addressed.

For example if the proposal is to improve the quality of high school graduates through increased spending at second level; changes in curricula; and improvements in teaching standards:

Benefits: May show themselves in increased third level participation and ultimately increased national competitiveness;

Risks: May be negligible impact from increased spend; industrial action through changes in work practices.

Once the EO has identified the benefits then it should quantify them in monetary terms. Some of the benefits may accrue to a specific sector, perhaps through cost savings from a regulation that is designed to reduce or simplify existing requirements. Where there is uncertainty, make it clear and spell out the assumptions used to determine the estimates.

Some benefits will be easy to estimate. Time for example can be quantified quite directly and relatively accurately by multiplying wages by the hours saved. Something less quantifiable would be enterprise level training. This could be estimated by examining revenue streams and productivity gains following training. There is likely to be uncertainty over the valuations, in which case, spell out the assumptions and use ranges.

Consider the extent to which other stakeholders (for example, consumers and the public sector) might be affected by the proposal. Benefits may accrue to a specific group such as workers, consumers, or low-income groups or to society in general.

Who are they? Can they help make the EO's case stronger?

Step 4: How can EOs utilize a CBA

To scale up a proper CBA then financial and human resources are needed. The requisite data needs to be sourced and it needs to be assembled with care. A CBA can be as technical an exercise as the EO wants to make it – depending on their capacity. It can factor in a whole range of economic variables into its analysis and undertake a deep technocratic exercise.

However, most EOs in developing countries will not have this capacity. But a CBA can be undertaken in a simpler fashion and still be a credible tool for policy change. The EO needs to ensure that it carries out this exercise as accurately as possible. Making inaccurate claims can be damaging to an EOs attempts to make a change in the constraint in the short term and in the longer term to its credibility.

Even where the EO is able to quantify relatively few costs (or benefits), using the CBA systematic approach to try to ensure that all benefits and costs have been identified and assessed will help to improve the quality of advice to decision-makers. Where costs have not been quantified, it is often possible to discuss them in qualitative terms, drawing some conclusions about their relative importance.

See the example below which can be convincingly made with not a great deal of effort.

EXAMPLE - EO POLICY POSITION: CHANGING REGULATION Y

EO CLAIM: "Regulation Y is currently costing business over \$80 million a year with most of this cost being met by SMEs"

The EO can make this call because through its surveys and focus groups, the EO ascertained the following information:

- a) Direct cost of compliance with this regulation is \$200 per year for every enterprise with fewer than 50 staff (first category) and \$500 for every enterprise with more than 50 employees (second category)
- b) Indirect costs to the first category of firms (SMEs) are estimated at an additional \$100 a year (i.e. administrative work required to maintain compliance with regulation entails 3 man hours to be carried out by administrative function (current market rates are \$15 per hour) plus an additional 2 hours professional fees)
- c) Indirect costs to the second category are less (these enterprises have the administrative capacity to absorb compliance easier). Indirect costs are therefore 1.5 man hours to be carried out by administrative function (current market rates are \$20 per hour) with no professional fees

Through information attained from the national statistics bureau, the EO can say that enterprises comprised of less than 50 employees make up 80% of all economic activity in the country and 20% have more than 50 employees. There are 20,000 enterprises in the first category in the country and 4,000 of the second.

The total estimated costs then to business are \$60,000,000 for SMEs and \$21,200,000 for larger enterprises. The aggregate cost to business annually is \$81,200,000.

On this basis the EO can make the following claim: The regulation annually is costing business \$81,200,000.

The EO could then go on to outline the implications of this lost revenue for the enterprise sector and how it has impacted on economic growth and jobs.

To carry out a CBA in practice take a sample of enterprises and work through the steps below.

Ensure the sample is representative of different sectors (including sectors in which women workers are dominant), sizes, and of GDP make up (e.g. if the mining sector accounts for 50% of GDP then ensure this is reflected in your sample). Also ensure that women-owned enterprises are included in the sample.

Work through the following questions:

CBA ASSESSMENT

BUSINESS	COSTS	BENEFITS
<p>What are the direct costs/benefits to enterprises also in approximate dollar amounts?</p> <p><i>* Include ongoing and 'once off' costs. Should also include all costs associated with the regulating from administrative work through to staff time</i></p>	<p>Example:</p> <ul style="list-style-type: none"> ▪ Costs of lost sales due to restricted access to markets ▪ Licence fees or other charges imposed by the regulations ▪ Cost of meeting reporting or record-keeping requirements imposed by the regulations ▪ Cost of internal inspections, audit fees etc to ensure compliance is being achieved 	<ul style="list-style-type: none"> ▪ Increased productivity/efficiency due to regulatory prohibitions on anti-competitive behaviours
<p>What are the indirect costs/benefits on business in dollar amounts?</p> <p><i>*Include ongoing and 'once off' costs</i></p>	<p>Example:</p> <ul style="list-style-type: none"> ▪ Costs of familiarising with the regulations and planning how to comply (may include purchase of external advice) ▪ Higher input costs due to regulatory impacts on the costs of materials ▪ Higher production costs due to changes to production, transport or marketing processes required by the regulations 	<p>Example:</p> <ul style="list-style-type: none"> ▪ Reductions in workplace accidents and injuries; associated productivity gains
<p>Are there particular costs/benefits implications for certain sectors, including sectors in which women workers are dominant?</p>	<p>Example:</p>	<p>Example:</p> <ul style="list-style-type: none"> ▪ through cost savings from a regulation that is designed to reduce or simplify existing requirements – or legislation with costs that particularly impact a sector e.g. OSH for heavy manufacturing
<p>Are there significant costs/benefits implications depending on enterprise size or on women-owned enterprises?</p>	<p>Example:</p> <p>exemptions based on enterprise size can lead to:</p> <ul style="list-style-type: none"> ▪ size traps in that they inhibit enterprises from growing beyond the threshold; ▪ unfair competition with enterprises that must comply; 	<p>Example:</p> <ul style="list-style-type: none"> ▪ exemptions based on enterprise size can conversely help sustain struggling emerging enterprises from costs that they cannot absorb as easily as larger entities

GOVERNMENT		
What are the gains/losses in revenue to government?	Example: <ul style="list-style-type: none"> ▪ Direct revenue losses 	Example: <ul style="list-style-type: none"> ▪ Direct revenue increases
What costs/benefits will government incur in developing and disseminating the policy? *Include ongoing and 'once off' costs	Example: <ul style="list-style-type: none"> ▪ Cost of administering the regulations: includes providing information to business, recruiting and training government staff, processing licence or product approval applications. ▪ Cost of verifying compliance: includes conducting inspections and audits, monitoring outputs. ▪ Cost of enforcement: includes investigating possible non-compliance, conducting prosecutions. 	Example: <ul style="list-style-type: none"> ▪ Ongoing revenue flow increased
WORKERS		
What are the costs/benefits of the regulation to workers?	Example: <ul style="list-style-type: none"> ▪ Loss of jobs if regulation places too onerous costs on enterprises 	Example: <ul style="list-style-type: none"> ▪ Better workplace protection
OTHERS		
Are there revenue gains to other parties	Example: <ul style="list-style-type: none"> ▪ Could be compulsory scheme mandated to third party for administration (such as a chamber providing 'certificate of origin' fee based service) 	Example: <ul style="list-style-type: none"> ▪ Losses to a revenue stream by eliminating a procedural obligation
CONSUMERS		
What are the costs/benefits of the regulation to consumers?	Example: <ul style="list-style-type: none"> ▪ Increased prices for products or services ▪ Reduced range of products available ▪ Delays in the introduction of new products (e.g. due to the need for producers to meet regulated product testing requirements) 	Example: <ul style="list-style-type: none"> ▪ Reduced prices for products or services (e.g. through regulatory restrictions on anti-competitive behaviours) ▪ Improved safety of goods and services ▪ Increased minimum quality standards for goods or services

ECONOMY

- changes in behaviour such as fewer enterprises setting up in business, reduced consumer choice, less taxation revenue, less competition between enterprises, less innovation, etc.
- Costs of reduced competition – e.g. by favouring existing producers and making entry to a market more difficult (leads to both efficiency losses and transfers from producers to consumers due to higher prices)
- Restrictions on innovation & the ability to develop and market new products and services



