

Unclassified

Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

PUMA/REG(98)13

OLIS : 24-Sep-1998

Dist. : 24-Sep-1998

Or. Eng.

PUBLIC MANAGEMENT SERVICE
PUBLIC MANAGEMENT COMMITTEE

THE PRELIMINARY REPORT ON THE STATE OF REGULATORY COMPLIANCE

The PUMA Regulatory Quality Review: Review of Japan and Mexico

Meeting of Regulatory Management and Reform Group, Public Management Committee,
OECD Headquarters, Château de la Muette, Paris, 22-23 October 1998

The objective of this preliminary report, prepared under contract for PUMA, is to assess the available evidence on regulatory compliance rates and trends, the reasons for compliance stresses, how governments are responding, and the major areas for further work in developing policy responses will be presented and discussed.

Participants will be asked to:

- Discuss the information and findings of this paper.*
- Submit their country's experience and examples which could improve the paper, or identify case studies from specific countries.*
- Discuss section 3.5 on "Other Directions for Further Work" and on the next steps the Secretariat should pursue in this field.*

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PRELIMINARY REPORT ON THE STATE OF REGULATORY COMPLIANCE¹

1. REGULATORY REFORM AND REGULATORY COMPLIANCE TRENDS

1.1 Regulatory Reform and Regulatory Compliance

1. The massive increase in social and economic regulation in all countries over this century has prompted many regulatory reforms in OECD countries.² In the initial phase of reforms, the focus was on *deregulation* - reducing rising regulatory burdens. However in areas like product standards, environmental quality, working conditions, safety and health, consumer and investor protection, it is clear that regulation is necessary due to the ever present possibility of market failures. In the second phase of regulatory reform, the focus shifted to *regulatory quality management* - improving the efficiency, flexibility, simplicity and effectiveness of individual regulations and non-regulatory instruments.

2. However the most apposite question in evaluating and reforming regulation is not the amount of regulation, nor even the quality of particular rules: It is whether regulatory systems are achieving the socially and economically optimal objectives they are set up to assure. Despite the massive increase in regulation over the last century, regulators and governments have collected little data that allows us to judge whether regulation has improved outcomes in important areas like environmental quality, occupational safety and health and consumer protection, and if so, at what cost.

3. In the third phase of regulatory reform in OECD countries - *the management of regulation* - the total impact of regulatory systems in achieving their social and economic goals has become the most significant criterion for measuring and managing the effectiveness of regulation. Central to this evaluation of regulatory performance is the question of *regulatory compliance*. Governments and regulators must now demonstrate that regulatory systems are designed to maximise compliance, at lowest cost, with the substantive regulatory goals.

4. The *Recommendation on Improving the Quality of Regulation* adopted by the council of the OECD in 1995 sets out standards for regulatory quality that demonstrate the significance of compliance outcomes in the total design of regulatory systems. (See Box 1.) The principles start with identification of the problem that needs to be solved and end with an assessment of whether the system will deliver an outcome that actually provides a solution. The middle stages require governments and regulators to consider what actions (regulatory or non-regulatory) are most likely to actually achieve the goal identified. The assessment and encouragement of regulatory compliance, in other words, is central to a focus on outcomes and regulatory goals, rather than inputs and regulations.

¹ This preliminary report was prepared by Dr Christine Parker, Law Faculty, University of New South Wales, Sydney, Australia.

² See Chapter 2 "Regulatory Quality and Public Sector Reform", *The OECD Report on Regulatory Reform. Volume II: Thematic Studies*, OECD 1997, pp191-248.

**Box 1: The OECD Recommendation on Improving the Quality of Government Regulation:
Checklist for Regulatory Decision-Making**

- Is the problem correctly defined?
- Is government action justified?
- Is regulation the best form of government action?
- Is there a legal basis for regulation?
- What is the appropriate level (or levels) of government for this action?
- Do the benefits of regulation justify the costs?
- Is the distribution of effects across society transparent?
- Is the regulation, clear, consistent, comprehensible and accessible to users?
- Have all interested parties had the opportunity to present their views?
- How will compliance be achieved?

Source: OECD (1997) *The OECD Report on Regulatory Reform. Volume II: Thematic Studies*, Chapter 2, p208.

5. As a result of regulatory reform, a new style of *compliance-oriented regulation* is emerging (see Box 2). Older styles of regulation focus on *command and control* regulatory mechanisms: The essence of command and control is the exercise of influence by imposing standards backed by criminal sanctions. The focus is on application of criminal sanctions by an external regulator or court after a breach has occurred. It is now generally recognised that command and control regulatory strategies are limited in that they can.

- produce unnecessarily complex and inflexible rules leading to over-regulation, legalism, delay and strangling of enterprise;
- produce the wrong outcomes when enterprises comply with rules that are too narrow or broad;
- encourage evasion and 'creative' compliance rather than compliance with the substance and goals of regulation;
- fail if regulatory agencies are 'captured' by regulated entities;
- fail when strong monitoring and enforcement are lacking.

Box 2: *Traditional versus New-Style Regulatory Systems**Traditional Command- and-Control Regulation*

Reflexive (automatic response to problem)
 Static
 Standardised
 Deliberative
 Means-oriented
 Opaque and interest-group-based
 Single-mission
 National
 Replacement of markets
 Effective
 Authoritarian and top-down

New Compliance-Oriented Regulation

Sceptical (is intervention really needed?)
 Dynamic
 Flexible
 Responsive
 Results-oriented
 Transparent and empirically-based
 Balanced and integrative
 Co-ordinated or harmonised internationally
 Strategic use of markets
 Cost-effective and efficient
 Co-operative and bottom-up

Adapted from: OECD (1997), *Regulatory Reform Report Vol II*, Chapter 2.

6. This paper examines how regulators can manage regulatory quality by reference to compliance as an outcome. It focuses on compliance with *social* regulation: Social regulation seeks to prevent unacceptable consequences to the environment, the workforce, consumers or clients and social cohesion. The 1997 OECD Report on Regulatory Reform stressed that this type of regulations is the one expanding the most rapidly in OECD countries, and accordingly is becoming an increasingly high priority for reform.

7. The remainder of Section 1 outlines some of the trends and stresses in regulatory compliance in OECD countries. The picture of compliance trends is very hazy due to a lack of empirical evaluations of the effects and performance of regulatory systems. This situation will improve as compliance-oriented regulatory reform continues and governments and regulatory agencies collect data evaluating their own performance. Section 2 of this paper catalogues the elements of innovative compliance-oriented regulatory strategies being used in OECD countries, and sets out the available evidence on their effectiveness. Section 3 outlines what this means for regulatory performance management within regulatory agencies, and the issues that merit further research.

1.2 Compliance Successes

Occupational Health and Safety

8. It is clear that dramatic improvements in occupational health and safety (OHS) outcomes apparently due to government regulation and intervention have occurred:

- For example since 1970 when the US Occupational Safety and Health Administration (OSHA) was created, the overall US workplace death rate has been cut in half. Since 1970, OSHA's cotton dust standard virtually eliminated brown lung disease in the textile industry, death from trench cave-ins declined 35%, and OSHA's lead standard reduced blood poisoning in battery plant and smelter works by two thirds.³

³ Source: OSHA 1998, "Success Stories" <http://www.osha.gov/oshinfo/success.html>

Environmental Protection

9. It is also clear that business has become much more responsive to community concern with environmental protection issues over the last 25 years and much more willing to comply or even go beyond compliance with environmental standards.

- A 1974 survey found that the majority of US companies viewed environmental management as a threat. In 1991 the same survey found that 77% of US companies had a formal system in place for proactively identifying major environmental issues. 76% felt environmental standards were reasonable or technically feasible. Indeed by 1991 49 Fortune 100 companies had environmental Vice Presidents and 31 of the Fortune 50 had them.⁴

Implementation of Corporate Compliance Systems

10. One of the most significant trends in regulatory compliance is the great increase in utilisation of formal corporate compliance systems by regulated companies and organisations over the last ten to fifteen years.

- Corporate compliance systems “aim to prevent, and where necessary, identify and respond to, breaches of laws, regulations, codes or organisational standards occurring in the organisation; promote a culture of compliance within the organisation; and assist the organisation in remaining or becoming a good corporate citizen.”⁵

11. Annexe One summarises the quantitative evidence available from studies in 3 countries on the implementation of corporate compliance programs. Corporate compliance programs seem to be strongest in the areas of environmental, OHS and financial services regulation. Equal employment opportunity and affirmative action compliance policies are also widely implemented, but to a lesser extent. The evidence also shows that corporate compliance systems are much more likely to be implemented by large enterprises than small and medium sized enterprises (SMEs). (As we shall see below, SMEs represent a recurring compliance stress).

12. The implementation of corporate compliance programs does not of itself necessarily represent an increase in compliance or in optimal regulatory outcomes. Indeed it is possible that corporate compliance systems are a response to unnecessarily complex laws, and high risks of private liability and bad publicity. But on the whole the growth in adoption of corporate compliance programs illustrates a widespread acceptance amongst big business of the need to be seen to be responsive to and ensure compliance with reasonable regulatory requirements and social pressures.

13. In addition to these broad trends evidence exists of many more compliance successes in response to particular regulatory programs and innovations. These will be discussed in Section 2 of this paper which outlines seven elements of compliance-oriented regulatory innovation that have shown some evidence of increasing compliance.

⁴ Hoffman, A. (1997), *From Heresy to Dogma: An Institutional History of Corporate Environmentalism*, The New Lexington Press, San Francisco, pp3-4, 23, 80-81, 123.

⁵ Standards Australia 1998, *AS3806-1998 Compliance Programs*, Standards Australia, Homebush, New South Wales, para.1.2.

1.3 Compliance Stresses: External Factors

14. Regulatory compliance faces many stresses from factors external to the regulatory system.

Economic Instability: Corporate Downsizing and Outsourcing

15. A number of studies show that high levels of corporate downsizing and outsourcing are threatening compliance with social regulation, particularly in occupational health and safety. Labour volatility, casualised employment and a weakening of labour unionisation weaken occupational health and safety outcomes:

- Census data from US, Australia and the United Kingdom indicates that self-employed workers have a significantly higher risk of serious injury and death than other employees so that increased outsourcing will increase OHS problems.
- Data from Sweden, US, Finland and Australia show that outsourcing is associated with increased OHS problems because of the economic and reward systems associated with outsourcing, more fractured and complex work processes and the fact regulations and compliance programs have conventionally focused on permanent employees in larger workplaces.
- Labour shedding by large companies contributes to increased workloads and deadline pressures, loss of corporate memory and expertise, insecurity generated stress and mental illness, reduced participation in 'non-essential' health training, job transfers and restructuring with insufficient attention to OHS which all have adverse effects on OHS outcomes.⁶

Small and Medium Sized Enterprises (SMEs)

16. Most studies of regulatory compliance with environmental and health and safety standards show that small firms are less likely to comply than larger enterprises and that accident frequency is several times higher in small companies than big ones. Some of the reasons for lower SME compliance rates are:

- their short-term orientation and narrow profit margins;
- their focus on production;
- the absence of economic and technological sophistication or of employees specialising in issues relating to compliance in SMEs;
- SMEs are weighed down by volume and complexity of information relating to regulatory standards;
- SMEs disproportionately bear the burden of costs of compliance due to the differential impact of cost of improvements and the relationship between cost to company and benefit which is likely to accrue from investment in compliance;
- larger or more hazardous sites are more frequently targeted for inspection by regulators..⁷

17. The differential in compliance between SMEs and larger enterprises is particularly evident in their implementation of formal compliance systems and is dramatically illustrated by a study of compliance by Norwegian enterprises with a regulation requiring them to have in place an environmental compliance internal control system. (See Box 3.)

⁶ Quinlan, M. (1998), "The implications of labour market restructuring in industrialised societies for occupational health and safety" mimeo, University of New South Wales, Sydney, Australia.

⁷ Aalders, M. & Wilthagen, T. (1997), "Moving beyond command-and-control: Reflexivity in the regulation of occupational health and safety and the environment" 19 *Law & Policy*, 415-443, p421; Genn, Hazel 1993 "Business responses to the regulation of health and safety in England" 15 *Law & Policy* 219-233.

**Box 3: Implementation of Internal Environmental Compliance Control Systems by SMEs:
A Norwegian Study**

The Norwegian internal control regulations (Ministry of Local Government, 1991) entered into force on 1 January 1992 and require all businesses and other organisations that employ people, both public and private, to establish and maintain a control system for environmental, health and safety issues. A 1994 evaluation of implementation of the requirement among 100 top managers found the following results.

Compliance by SMEs (90% of Norwegian corporations):

- 43% of managers in corporations with annual sales of under 100 million NOK had never heard of the regulations

Compliance by larger enterprises (10% of Norwegian enterprises):

- 6% of managers in corporations with annual sales of over 100 million NOK had never heard of the regulations.

Overall compliance:

- Overall only 31% of top managers were strongly engaged in implementing the system.
- 32% were not interested in implementing a system.

Source: Andersen, O. (1996), "The Norwegian internal control system: A tool in corporate environmental management?" 3 *Eco-Management and Auditing*, 26-29.

18. Economic instability and the rising popularity of outsourcing have led to an increased proportion of SMEs (small business now accounts for 40% of total employment in industrialised countries⁸), making SME non-compliance a major stress on regulatory systems.

1.3.3 The Cash Economy

19. The informal or cash economy is another source of particular compliance stress.

- For example, recent Australian research shows that there is a widespread view in the community that not paying tax on cash is acceptable, and that there is a perception there is little likelihood of detection of evading tax in this way. Academic studies estimate cash economy to be between 3.5% and 13.4% of GDP so annual amount of income tax revenue foregone could be between \$3.9 bill and \$15.1 bill.⁹

20. In countries where the proportion of the economy invested in the cash economy is greater, non-compliance will be a greater problem. This is likely to be a particular issue for economies in transition in Central and Eastern Europe.

1.3.4 Governments' Fiscal Consolidation

21. Governments' fiscal consolidation leads to compliance stresses due in particular to

- budgetary restrictions so that less money is spent on staff and enforcement in regulatory areas
- more pressure to deal with an issue by promulgating regulations rather than spending money on solving it

⁸ Quinlan, M. (1998), "The implications of labour market restructuring in industrialised societies for occupational health and safety" mimeo, University of New South Wales, Sydney, Australia.

⁹ Australian Tax Office 1998, *Improving Tax Compliance in the Cash Economy: Cash Economy Task Force Report*.

1.3.5 Economies/Polities in Transition

22. Economies in transition face particular compliance challenges due to historical, political and economic factors such as:

- budgetary restrictions, loss of key staff and frequent changes in political leadership have hampered the development of regulatory legislation and policies
- lack of law drafting expertise
- little experience in regulating private actors.

1.4 Compliance Stresses: Internal Factors

23. Apart from these external challenges to compliance, internal factors of the form or style of regulation can cause major compliance stresses. An earlier PUMA/OECD paper on *Improving Regulatory Compliance* identified eight causes of non-compliance that relate to regulatory design and implementation:¹⁰

1. Failure of understanding of law: If business does not understand the law, it cannot comply.
2. Collapse of belief in the law: Lack of belief in the substantive justification for either detailed rules or broad policy objectives will lead to non-compliance.
3. Procedural injustice: Lack of belief in the legitimacy of the procedures for the enactment, implementation and enforcement of the law will lead to non-compliance.
4. Costs of regulatory compliance: If the cost of compliance is too great, business may not be able to comply.
5. Deterrence failure: Because so many kinds of business law-breaking have high rewards and low probabilities of detection or low penalties, threatened application of sanctions may fail to deter non-compliance.
6. Incapacitation failure: The application of sanctions designed to stop non-compliance by withdrawing a license or issuing an injunction, for example, may fail.
7. Failure of persuasion: The above failures may mean that the regulatory system as a whole fails to persuade business that compliance is wise.
8. Failure of civil society: Regulatory laws may ignore or destroy institutions of civil society such as business schools, professional associations, industry self-regulatory schemes, trade unions or social movements, that help nurture compliance.

24. The mere proliferation of regulation will not necessarily increase compliance with the socially desirable goals of regulation. Indeed increased regulatory rule-making and activity may decrease compliance through increased failure of knowledge or understanding of regulation, increased costs of regulatory compliance, or increased complexity facing regulatory agencies who therefore cannot implement strategic enforcement activities:

- For example, in Argentina as inspections of tax files and audits and other regulatory activity has increased since the early 1990s, so has the sophistication of tax non-compliance. After an initial surge in tax compliance around 1992, however, compliance decreased again as businessmen and

¹⁰ Braithwaite, J, 1993, *Improving Regulatory Compliance: Strategies and Practical Applications in OECD Countries*, OECD, Paris.

entrepreneurs incorporated more complex evasion mechanisms and less traceable documentation into their tax evasion strategies. Because in Argentina the majority do not comply with tax laws and escape, even when the tax administration modernised, it still faced a failure of deterrence and of persuasion that actually increased tax non-compliance by increasing the sophistication of tax evasion. Lack of strategy in deciding which cases to prosecute so perceive ineffectiveness.¹¹

2. COMPLIANCE-FRIENDLY REGULATORY INNOVATION

2.1 Introduction

25. This section catalogues seven ways in which governments have experimented with innovative compliance-friendly regulatory strategies and the evidence as to their effectiveness. They are presented in the chronological order in which they could be incorporated into regulatory design and implementation to form a total approach to compliance-friendly regulation:

Stage One:

A. Problem Identification and Analysis

Stage Two:

- B. Harness private capacity to secure compliance through alternatives to public regulation
- C. Public regulation that maximises the possibility for voluntary compliance
- D. Rewards and incentives for high/voluntary compliance
- E. Nurture compliance capacity in business

Stage Three:

- F. Monitor for non-compliance
- G. Dialogue and restorative justice when voluntary compliance fails
- H. Tit for tat enforcement when restorative justice fails.

26. Some governments have already attempted to take a comprehensive quality management approach to encouraging compliance-oriented regulation. They have required regulatory policy development to move beyond regulatory impact assessment (which focuses on assessment of compliance costs) to looking at the total factors of regulatory rule-making, monitoring and enforcement that affect compliance:

- In 1992 the Canadian Regulatory Compliance Project of the Department of Justice produced a guide for regulators to encourage them to develop compliance policies to improve the compliance-friendliness of their regulatory systems. (See Box 4.)
- In the Netherlands the Inspectorate of Law Assessment within the Ministry of Justice has developed a table of eleven key determinants of compliance as one of the standard checklists that public agencies should use in assessing new regulatory proposals and reviewing old regulations. (See Box 4.)

¹¹ Bergman, M. (1998), "Criminal law and tax compliance in Argentina: Testing the limits of deterrence" 26 *International Journal of the Sociology of Law*, 55-74.

Box 4: Regulatory Management Tools for Encouraging Compliance-Friendly Regulation

The Netherlands: Table of Eleven Key Determinants of Compliance:

The Table of Eleven is used to guide reviews of compliance and enforcement in relation to existing legislation and as an analytical tool in the development of new regulation. The table is in three parts:

Spontaneous Compliance Dimensions:

Factors that affect the incidence of voluntary compliance - that is, compliance which would occur in the absence of enforcement; including the level of knowledge and understanding of the rules, the benefits and costs of complying, the level of acceptance of the 'reasonableness' of the regulations, general attitudes to compliance by the target group, and 'informal control' and the possibility of non-compliance being sanctioned by non-government actors.

Control Dimensions:

The probability of detection of non-complying behaviour. The factors considered are the probability of third parties revealing non-compliance, the probability of inspection by government officials, the probability of inspection actually uncovering non-compliance and the ability of inspection authorities to target inspections effectively.

Sanctions Dimensions:

The expected value of sanctions for non-compliance, that is, the probability of sanctions being imposed where non-compliance is detected and the severity and type of likely sanctions.

Source: Public Management Service, OECD (1998) *Improving Government Capacity to Assure High Quality Regulation: Draft Country Review of the Netherlands*, OECD, Paris.

Canada: Strategic Compliance Policies for Regulators

In 1992 the Canadian Regulatory Compliance Project produced a guide to help public agencies develop compliance strategies for conducting their regulatory 'business'. The aim of the compliance strategy is to get the biggest possible pay-off from a program's activities and scarce resources by maximising leverage of both activities and resources. The development of a compliance strategy involves consideration and effective use of the following key factors that affect compliance:

<u>Objectives of the Regulatory Program:</u>	Should be clear, concise, measurable and internally consistent.
<u>Rules and Design of the Program:</u>	
<u>Roles and Functions of Key Authorities:</u>	Every official who performs a function in the regulatory system should be identified.
<u>Regulated Group:</u>	Geographic location, market structure, size of firms, nature of ownership, whether importer or domestic producer, how business is operated on a daily basis.
<u>Potential Allies:</u>	Identify the people who benefit from the program and potential allies among the regulated group who may have an interest or capability to secure compliance.
<u>Factors that Affect Compliance:</u>	Look at understanding and acceptance of the objectives and rules of the regulatory program; enforceability of the rules; capability of the regulated group to comply; social and psychological factors; economic considerations; capability of the regulatory program to monitor, promote and enforce compliance. Enhance the natural incentives to comply and minimise the disincentives.
<u>Compliance Profile:</u>	A map that shows who is obeying which rules should be used to set priorities for the program by reference to types of violations that pose the greatest risks to the program's objectives.

Source: Regulatory Compliance Project (Department of Justice) (1992) *A Strategic Approach to Developing Compliance Policies*, Government of Canada.

2.2 Stage One

A. Problem Identification and Analysis

27. Innovative compliance-oriented regulation focuses on problem identification and analysis first, rather than on rules. Governments that begin regulatory design or review by systematically identifying important hazards, risks, or patterns of non-compliance, and prioritising the problems they wish to solve have achieved major strategic breakthroughs in improving the achievement of regulatory goals.

28. Regulators and policy-makers then look for an effective and efficient solution to the problem identified. The solution is likely to require a mix of tools and strategies and a dynamic, responsive approach that is tailored to different regulated groups. It will mean looking at total regulatory system design including rule-making, monitoring and enforcement.

29. When the solution is implemented, in order to ensure its quality, policy-makers must continually go back to the problem identification phase to monitor whether the solution is having the desired effects.

30. Because regulatory agencies cannot enforce every rule or cover every problem it is important to develop the capacity to use information to focus on high priority problems. This has profound implications for the information management capacities of regulators because it requires adequate collection and analysis of data about risks and problems. Many successful regulatory innovations/experiments have begun with the collection and analysis of information about compliance rates and the nature of a regulated industry. That information is then used to identify and prioritise problems, craft suitable solutions and to monitor the results. See Box 5 for an example of how US OSHA's Maine 200 Program used information analysis to identify and improve compliance in a particular risk group.

Box 5: US OSHA's Maine 200 Program

One dramatic way in which innovative information management combined with risk assessment and prioritisation was used to increase desirable regulatory outcomes was an OSHA experiment initiated in 1993 in Maine. The Maine OSHA office used its databases to identify the 200 employers with the highest number of injuries in their area. Each was given work site specific injury and illness profiles and then asked to 'choose their OSHA': Either they could use OSHA's help to survey hazards, and correct and implement worksite safety systems or else they would be targeted for more frequent traditional comprehensive inspections because of their risk prioritisation. All but 2 firms chose partnership with OSHA.

Results:

- Total workers compensation claims dropped by 35% in those worksites during the program.
- 182 employers identified 95800 hazards and abated 55200 of them (in comparison with the 36780 that OSHA inspectors had discovered and cited in the previous eight years at those sites).
- At least 320 worksite health and safety committees were established.
- Nearly 60% of employers reduced their injury and illness rates even as fines and inspections diminished.

OSHA is expanding the most successful features of this program nationwide by using worksite specific data to help identify high hazard workplaces, provide information to employers about effective safety and health programs and offer employers a choice in how they want to work with OSHA.

OSHA is also experimenting with focused inspections, using their data and hazard analysis capabilities in different industries. Where OSHA finds a strong health and safety program, the agency conducts a limited inspection limited to the top 4 hazards which kill workers in that industry based on its informational analysis. For example in the construction industry they are falls from heights, electrocution, crushing injuries and being struck by material or equipment. If these hazards are well controlled, the inspection finishes. If there is no health and safety program or if it is ineffective in those areas, then a complete site inspection with full citations is undertaken.

Sources: Sparrow, M. (1996) "Regulatory Reform: Lessons from the Innovations Awards Program" Mimeo, John F. Kennedy School of Government, Harvard University & OSHA website (<http://www.osha.gov/oshinfo/reinvent/reinvent.html>)

2.3 Stage Two

B. Harness Private Capacity to Secure Compliance through Alternatives to Public Regulation

31. The next step in compliance-oriented innovation is to experiment with a variety of means to harness the capacity of private actors or organisations to regulate themselves through *self-regulation, voluntary agreements, management standards or market mechanisms* to achieve regulatory goals. The aim is to harness private capacities to secure compliance with regulatory goals. Under this system, the role of governments is to facilitate the constructive contributions of non-government interests, rather than act as commanders.¹²

32. Generally the *advantages* of enlisting non-governmental institutions to achieve regulatory goals are that:

- some of the regulatory and resource burden on government to achieve socially optimal goals is reduced;

¹² See generally Grabosky, P. (1995), "Using non-governmental resources to foster regulatory compliance" 8 *Governance: An International Journal of Policy and Administration* 527-550.

- those with greatest capacity to help secure compliance are identified and given responsibility to do so, rather than over-reliance on central government functions;
- regulatees may be more likely to comply with standards that they have participated in designing to be compatible with their own goals and industry conditions;
- a wider group of affected parties may potentially be included in the development of standards and monitoring.

33. The potential *disadvantages* of such strategies are that:

- private regulatory systems may proliferate that are not subject to the same publicity and accountability standards as government legislation and regulation;
- these schemes usually require some form of government support in the form of monitoring and enforcement in order to be effective and therefore they cannot escape the costs and problems of public regulatory activity all together;
- badly designed schemes can delay needed government regulation and result in loss of community trust in the relevant industry and even the government.

34. *Self-regulation* can be defined as an arrangement in which an organised group regulates the behaviour of its members. There are many possible co-operative or co-regulatory arrangements in which private organisations and government could share regulatory authority and oversight in a particular area. Self-regulation often includes the use of a code of conduct to govern members of the self-regulatory scheme. The most basic self-regulatory schemes involve voluntary compliance with a code of conduct which include some dispute resolution arrangement.

35. There is little evidence on how effective self-regulatory schemes are:

- The British Office of Fair Trading has recently re-evaluated its scheme for encouraging voluntary codes of conduct on the basis that it believes they are generally not very effective. In 1998 the Office reported that ‘successive monitoring exercises revealed patchy levels of compliance and fairly widespread ignorance or apathy among traders and the public alike’.¹³

36. However there is evidence that some self-regulatory schemes have been effective at improving regulatory outcomes:

- One is the Chemical Industry Association’s Responsible Care scheme which started with the Canadian Chemical Producers’ Association and now operates in 41 countries and reaches around 88% of the global chemical industry.¹⁴ Since 1987 the US chemical industry claims to have used Responsible Care to reduce releases of toxic chemicals to the environment by 49%, reduced disposal in deep wells by 46%, and reduced off-site transfer for treatment and disposal by 56%.¹⁵
- The Consumers Council of Canada conducted a survey of knowledgeable consumers and preliminary results suggest that respondents were favourably disposed towards voluntary codes particularly when

¹³ Office of Fair Trading 1998, *Raising Standards of Consumer Care: Progressing Beyond Codes of Practice*, Her Majesty’s Stationery Office, Great Britain, p13.

¹⁴ See OECD 1997, *Public Management Occasional Papers No. 18 Co-operative Approaches to Regulation*, OECD Publications, Paris pp 13-20.

¹⁵ Gunningham, N. (1998) “Environmental management systems and community participation: Rethinking chemical industry regulation” mimeo, Australian Centre for Environmental Law, Faculty of Law, Australian National University.

consumers are equal stakeholders with business, the codes are well publicised, an entire industry is covered and sanctions have real teeth. The two concerns rated most highly by consumers were: Will a seller be available to deal with complaints and does a product with hidden qualities meet the appropriate standards? Survey respondents clearly indicated they would be more comfortable with a code when there was some government involvement and support.¹⁶

37. *Voluntary agreements* between government and a private body or group of private bodies can also be used as an alternative to formal public regulation and self-regulation. The use of voluntary agreements gives government a greater capacity to be involved in consultation, participation and partnership with the private body or bodies who take responsibility for achieving regulatory goals.

- For example, in the Netherlands, the Oele Committee is a group of senior statesmen and industrialists who are dealing with soil pollution. Companies voluntarily join a system of corporate collaboration to look at soil pollution. They are then entitled to government aid in the conduct of a sequence of surveys that may either lead to the public reporting of what the surveys revealed or to clean ups, depending on the environmental risk shown by the surveys. Each Dutch province has a foundation overseeing the system and reporting regularly to Parliament. Those companies which do not take part may find that expensive investigations and clean ups are forced upon them.
- Globally voluntary agreements are being extensively used to avoid the need for restrictive regulation and legislation in controlling greenhouse gas emissions. In this area voluntary agreements are an attractive means of discharging international obligations to reduce emissions without imposing politically unpalatable regulation or carbon taxes. In Norway 325 companies are participating in such a program in 12 trade groups covering 80% of energy used in industry.¹⁷ In Australia, industry associations initiated the idea of the Greenhouse Challenge Program to avoid the much more onerous potential of a carbon tax. Well over 100 members, including approximately 80% of enterprises in the electricity business, are now implementing plans to reduce greenhouse gas emissions which will be audited by government.

38. Another way for governments and regulators to harness private capacities to secure compliance is through encouraging the adoption of *industry standards and internal management systems* to ensure outcomes that accord with regulatory goals. Here governments enlist the support of internal corporate managements (rather than self-regulatory organisations or industries) to achieve regulatory goals in a way that is consistent with their own individual business goals and innovative capacity.

- For example the British Office of Fair Trading has recently raised the possibility of replacing its endorsement of certain industry codes of conduct with the encouragement of industry standards for fair practice. Standards would be drawn up under the processes of the British Standards Institution and all those with a direct interest would participate. A core standard would be applicable to all business and would require that all sectoral standards include low cost dispute resolution systems. To administer the new scheme, the Office of Fair Trading proposes creation of a new approval body that would vet all applicants, monitor their behaviour and deal with complaints. In return successful applicants would be able to use a new cross-sectoral quality logo.¹⁸

¹⁶ See Office of Consumer Affairs (Industry Canada) & Regulatory Affairs Division (Treasury Board Secretariat) 1998, *Voluntary Codes: A Guide for Their Development and Use*, Government of Canada.

¹⁷ Jutsen, J. 1995, "Voluntary agreements with industry for reducing greenhouse gas emissions" in *Towards a Sustainable Future: Challenges and Responses*, National Conference on Environmental Engineering, Melbourne.

¹⁸ Office of Fair Trading 1998, *Raising Standards of Consumer Care: Progressing Beyond Codes of Practice*, Her Majesty's Stationery Office, Great Britain.

- Australia and the United Kingdom lead the world in development of standards for OHS management systems.¹⁹
- Australia leads the world in the development of a standard for corporate compliance systems generally.²⁰

39. The particular advantages of government encouragement of corporate implementation of internal management standards include:

- This strategy takes advantage of existing processes and institutions of national and international standards associations for ensuring participation of all affected groups in development of the standard by consensus;
- Organisations who wish to utilise a standard can privately pay for accreditation to the standard therefore reducing the need for government expenditure on inspections;
- Internal management standards can combine regulatory goals or values and business concerns in a way that government rule-making cannot. Indeed a range of studies suggest that those enterprises that adopt environmental management systems, for example, can achieve impressive outcomes in terms of environmental performance;²¹

40. However the evidence suggests that implementation of internal management standards that ensure compliance with regulatory goals is likely to be patchy and weak (see Annex One) unless government backs them up with some sanction or incentive for implementation. For example, the Netherlands government is stimulating the development and adoption of Internal Company Environmental Management systems (ICEMs) through giving companies who have implemented an effective ICEM access to a more flexible environmental permitting system. (See Box 6.)

¹⁹ For example, BS8800: Guidance on occupational health and safety management systems, London, BSI, 1996. See Glendon, I. & Waring, A. 1997, "Risk management as a framework for occupational health and safety", 13 *Australian and New Zealand Journal of Occupational Health and Safety*, 525-532.

²⁰ AS3806 - Compliance Programs.

²¹ See Gunningham, N. 1998, "Environmental management systems and community participation: Rethinking chemical industry regulation" mimeo, Australian Centre for Environmental Law, Faculty of Law, Australian National University.

**Box 6: Dutch Systems of Internal Company Environmental Management (ICEM)
and Flexible Permitting**

Since 1988 the Netherlands government has been encouraging adoption of ICEMs. Governmental supervising and inspection of environmental compliance is shifting from purely inspecting compliance with environmental regulations to supervising and testing the correct operation of corporate environmental management systems. Companies without an effective environment management system are sooner considered for intensified enforcement activities.

The government's original policy objective of 10 000 larger companies having an operational ICEM by 1995 was unachievable. By 1995 35 companies had properly validated their implementation of ICEM on the basis of BS 7750 (the standard designed by the British Standards Institute) as determined by recognised auditing bureaus. However there has been some success in linking ICEM implementation with environmental permits. Companies with ICEMs of a high enough standard are entitled to obtain a more flexible environmental permit which allows them a greater degree of self-regulation and more lenient enforcement policies.

- An evaluation of 16 companies that had either established a link between their ICEM and their environmental permit under the Environmental Management Act 1993 or were in the process of doing so found that in ten of the sixteen companies the linkage proved to be a success. The others failed because the firm asked for more flexibility than allowed or because the government eventually opted for a stricter permit.
- However the enforcement of flexible permits poses problems and there has also been criticism that the conditions under which these permits were granted was not made public enough, and that there was not enough consultation.

Sources: Aalders, Marius (1993) "Regulation and in-company environmental management in the Netherlands" 15 *Law & Policy* 75-94; Aalders, Marius & Wilthagen, Ton (1997) "Moving beyond command-and-control: Reflexivity in the regulation of occupational health and safety and the environment" 19 *Law & Policy*, 415-443.

41. The fourth way in which governments can harness private capacities to achieve regulatory goals is through the harnessing of *market mechanisms* to ensure compliance with a regulatory goal. This may be through the use of economic incentives such as the application of taxes, charges, subsidies, user pricing or refund schemes to internalise externalities so as to achieve more socially optimal outcomes; or through limiting the ability of organisations to engage in an undesirable activity and making the right to do it tradeable in the market place through tradeable permits.

- For example, the US emissions trading program implemented under the 1990 Clean Air Act amendments has been estimated to have saved something in the range of \$4 billion in abatement costs compared to what would have been spent by making use of more traditional approaches to the regulation of pollution to achieve equivalent reductions.
- In New Zealand tradeable permits are used to manage fisheries. The externality there is that the free choices of fishers tend towards over-fishing. Fishers now purchase the right to catch a given number of fish per year and the government determines the optimal catch each year. Then it either buys back some of the permits or sells some more to ensure that optimal level is realised.²²

42. There has been little experience to gauge the success of economic instruments such as tradeable permits in increasing achievement of regulatory goals. Where they have been used, they have been very complex and their success remains dependent on government monitoring and enforcement of compliance with permit conditions:

²² Treasury Board of Canada Secretariat 1992, *Regulating in the 90s: Competitiveness and the Design of Regulations*, Canada, p17.

C. Public Regulation That Maximises Voluntary Compliance

43. Where it is not possible to harness private alternatives to public regulation, public regulations should be designed to maximise the possibility for voluntary compliance.

Performance Standards Instead of Specification Rules

44. One way in which voluntary compliance might be increased is through using regulation to mandate the policy goal itself via broad outcome standards instead of prescribing rules or procedures which might be expected to result in the achievement of the goal.

- *Rules* generally take the form, 'in circumstance X, do Y or not-Y'.
- A *standard* requires the pursuit or achievement of a value, a goal or outcome without specifying the actions required to do so.

45. By focusing on results (outcomes) rather than on the means for achieving them (inputs), standards permits each regulated entity greater freedom of action to find the lowest-cost or best means of complying for itself and can therefore increase compliance and innovation.

46. The disadvantages of such an approach are that:

- there may be uncertainty regarding what constitutes acceptable compliance;
- it may favour larger firms with a greater capacity to innovate over smaller firms;
- it may be difficult for regulators to monitor and enforce compliance with broader standards.

47. However there is some evidence that broad outcome-based standards are actually easier to apply, monitor and enforce than many specific rules, especially if they have been developed in a process of dialogue and consultation between regulator and regulatee. (See Box 8.)

Box 8: Rules versus Standards - The Nursing Home Study

In the US there are over 500 federal standards that nursing homes must meet to demonstrate they reach an appropriate level of care. They are supplemented by state standards that may exceed the federal standards by a factor of two or three. This is a regulatory model based on specification rules.

By contrast in Australia there are only 31 broad outcome-oriented standards for nursing homes that were settled consensually between industry and major stakeholders. For example, a myriad of US rules about treatments, dressings and recording of pain problems in care plans are replaced by a single ‘freedom from pain’ standard.

Cross-country evaluative research of the implementation of the two sets of rules showed that it is the broad Australian standards that are more reliably rated by inspector teams than the narrow and specific US rules. The 31 broad outcome standards mean that Australian inspection teams can discuss all the standards with each other and with the nursing home staff, can ensure that they have collected evidence on positives and negatives for each nursing home relevant to compliance with each standard and can discuss both positives and negatives of each standard with the nursing home staff. In contrast the US teams can only tag several standards that have not been met to raise problems. They cannot ensure they have collected evidence on all 500 standards and cannot discuss both positives and negatives related to each standard with nursing home staff. As a result they concentrate on discussing the unmet standards.

Inspectors in Australia could also use the outcome-based standards more efficiently to talk to residents and staff about how quality of care could be improved and, as a result, agreed action plans to restore residents’ rights to quality of care were overwhelmingly implemented.

Source: Braithwaite, J. & Braithwaite, V. (1995) “The politics of legalism: Rules versus standards in nursing-home regulation” 4 *Social & Legal Studies*, 307–341.

48. More flexible regulatory design can also improve compliance by reducing the costs of compliance with technical rules and encouraging innovation to find the most effective ways to reach socially desired outcomes. (See example in Box 9.)

**Box 9: Regulatory Flexibility and Regulatory Innovation:
The Amoco Yorktown Experiment**

Where regulators are willing to use more flexible, compliance-oriented regulatory tools, possibility for both savings and socially desirable outcomes can increase. For example in 1990 Amoco and the US Environmental Protection Authority formed a partnership to study the pollution reduction possibilities at the company’s Yorktown refinery. They also commissioned a non-profit environmental research group to peer review their findings. They found that Amoco would be able to achieve the same level of emissions reduction required under the US Clean Air Act for a quarter of the cost (US\$10 million instead of US\$40 million) if the EPA would allow Amoco to decide where the money should be spent through innovations in process engineering, rather than applying its specific rules. However the whole exercise cost US\$2.3 million and, although the EPA paid 30% of that cost, other Amoco plants and other companies in the refining business did not want to spend that amount of money looking for money-saving options. As a result Amoco has started the Environmental Innovations Program that is trying to sell to both business and government the benefits of greater regulatory flexibility for compliance with environmental regulation.

Source: Schmitt, Ronald (1994) “The Amoco/EPA Yorktown Experience and Regulating the Right Thing” 9(1) *Natural Resources and Environment*, 11-13, 51.

49. Harvard Business School Professor, Michael Porter has suggested that environmental regulation can be good for competitiveness if it is innovation friendly in the following ways:

- Focus on outcomes not technologies
- Enact strict rather than lax regulation

- Regulate as close to the end user as practical while encouraging endstream solutions
- Employ phase-in periods
- Use market incentives
- Harmonise or converge regulations in associated fields
- Develop regulations in sync with other countries or slightly ahead of them
- Make the regulatory process more stable and predictable
- Require industry participation in setting standards from the beginning
- Develop strong technical capabilities among regulators
- Minimise the time and resources consumer in the regulatory process itself.²³

Process Regulations

50. Another way to improve the compliance-friendliness of regulation is to introduce a regulatory regime aimed at a broad outcome, which requires firms to introduce a management system aimed at the regulatory goal. This approach allows businesses to make their own decisions about how to achieve the goal by setting a procedure that requires them to engage with it without setting any specific rules for what firms are required to do. It produces behaviour designed to prevent problems before they occur; can harmonise with international standards; firms are placed in more direct control of firm specific hazard reduction rather than one-size-fits-all solutions worked out by government agencies. Examples include environmental management requirements; maintenance of food/product safety standards and occupational health and safety risk management.

51. Process regulations are often based on requiring organisations to take a systematic approach to identifying, controlling and minimising risks. For example there is a movement in both OHS and food regulation towards requiring firms to engage in their own process of hazard identification, risk assessment and risk control to achieve safety outcomes.

- ‘HACCP’ principles are being recognised internationally as a way of minimising food adulteration risks. Regulatory systems that use the HACCP system place the responsibility to determine and control for problems with the individual firms, allowing for a tailored approach to addressing risk rather than a one-size-fits-all regulatory strategy. The seven HACCP components are:
 1. Hazard analysis: the identification of likely hazards that could occur in specific products as a result of specific processes, including microbiological substances, toxins, chemicals, drugs, and physical objects.
 2. Critical control points (CCPs): the elements of the production process that are most important in terms of a failure to establish adequate preventative measures that could lead to potential health hazards.
 3. Critical limits: the measured levels of performance controls at CCPs (e.g. a temperature range for refrigeration).
 4. Monitoring: keeping watch of the CCPs to assess whether controls are within the critical limits.
 5. Corrective action: the steps taken when monitoring indicates critical limits have been passed, including holding the product until safety has been evaluated.
 6. Record keeping: recording and maintaining information about the results of monitoring, the taking of corrective actions, and verification.

²³ Porter, M. & van der Linde, C. 1995, “Green and competitive: Ending the stalemate” September–October *Harvard Business Review*, 120–134.

7. Verification: reviewing all HACCP components periodically or when a production element changes.²⁴

52. Other advantages of process regulations include that they give firms the opportunity to incorporate regulatory goals into other business goals and operating procedures, and their flexibility may make controversial regulation more politically palatable.

- For example, Australia's affirmative action regime fits in with business goals of good human resource management, rather than imposing particular targets for equal employment. (See Box 10.)

Box 10: Process Regulation and Australia's Affirmative Action Regime

In 1986 the Australian *Affirmative Action (Equal Employment Opportunity for Women) Act 1986* (Cth) was passed mandating all companies with over 100 employees to develop an equal employment opportunity policy, set objectives, monitor them and submit a report on their progress to the federal Affirmative Action Agency each year.

The Australian Affirmative Action Act requires employers to establish affirmative action programs incorporating:

- issuing an equal employment opportunity policy statement to all employees
- assigning responsibility to a senior officer
- consulting with trade unions
- consulting with employees, particularly women
- the collection of statistics to observe the gender y job classification breakdown
- a review of personnel policies and practices
- setting of forward estimates an objectives
- monitoring and evaluation of the program.

An evaluation of compliance with the Affirmative Action Act found that 96% of those businesses registered with the Affirmative Action Agency had submitted a report to the Agency as required by the Act. Other research has shown that women's managerial representation has increased at a significantly higher rate in firms covered by the legislation than in those that are not, and that affirmative action programs in general have steadily improved since the regime was introduced. Commitment to the business goal of human resources management correlated highly with both procedural compliance with the eight steps, and with the more substantive compliance measure of reported implementation of practices that actually accommodated women in the workplace.

Source: Braithwaite, V. (1993) "The Australian government's affirmative action legislation: Achieving social change through human resource management" 15(4) *Law & Policy*, 327-354; Affirmative Action Agency (1997) *Annual Report 1996-1997*.

53. The *disadvantages* of process regulations include that systematic managerial approaches to achieving regulatory goals can be very expensive, especially for small business, and can be difficult to monitor and enforce.

Safe Harbours and Alternative Compliance Mechanisms

54. Another way to gain the advantages of increased compliance through more flexible public regulation is through the use of *safe harbours* and *alternative compliance mechanisms*. These are ways of providing performance-based regulation, while at the same time providing guidance to regulated entities.

²⁴ See OECD 1997, *Public Management Occasional Papers No. 18 Co-operative Approaches to Regulation*, OECD Publications, Paris, Chapter 4.

55. *Safe harbours* are when regulation includes both a set of performance standards and a set of detailed rules for meeting them. For example, occupational safety and health legislation in the UK sets broad performance standards but also detailed codes of practice for guidance that regulated entities can follow in order to meet the broad standards.

56. *Alternative compliance mechanisms* are mechanisms that allow particular regulated entities to show a regulator that they are meeting the goal of particular regulation in some other way than that prescribed by the legislation and therefore should be waived from compliance with the particular requirements of the rules. The aim is to relieve the public especially business from the effects of unnecessary or burdensome regulations, but there is a potential problem with giving the executive too much discretion to substitute regulations with private agreements. Therefore governments have had troubles implementing such schemes:

- For example the *Canadian Regulatory Efficiency Bill 1994* (which did not become law) would have allowed approved regulatory authorities to approve an alternative compliance mechanism in substitution for designated regulations or Acts. The alternative compliance mechanisms would have to meet the regulatory objectives of the relevant regulations but not the specific prescriptive requirements. Comparable approaches are being pursued in Victoria State, Australia, and in Mexico at the federal level.
- Similarly the US *Comprehensive Regulatory Reform Bill* (which also did not become law) would have allowed any person subject to a major rule to petition the relevant agency to modify or waive the specific requirements of the major rules and to authorise the person to demonstrate compliance through alternative means not otherwise permitted by the major rule.²⁵

D. Rewards and Incentives for High/Voluntary Compliance

57. The design of rules and, particularly, of monitoring and enforcement regimes can also encourage compliance by providing incentives or rewards for high voluntary compliance and compliance innovation.

- One well established example of how this can improve socially desirable outcome is US OSHA's Voluntary Protection Program. (See Box 12.)

²⁵ See Law Reform Committee (Victoria) 1997, *Regulatory Efficiency Legislation: Discussion Paper*, Parliament of Victoria, Melbourne.

Box 12: OSHA's Voluntary Protection Program (VPP)

Under this program OSHA recognises outstanding achievement by companies that successfully integrate a comprehensive safety and health program into their total management system. The Program was adopted by OSHA in 1982 with the purpose of emphasising the importance of employer-provided site-specific OSH programs and encouraging improvement and excellence. The program now covers about 214000 employees at 370 worksites

Applicants to VPP must demonstrate in writing that their occupational safety and health compliance program includes the following elements:

1. Management commitment and employee involvement;
2. Worksite based job hazard analysis including baseline surveys of working conditions throughout the facility;
3. Hazard prevention and control;
4. Safety and health training.

The process also requires follow up using annual program evaluations, verified by OSHA on-site every one to five years. The detailed steps for each of these components must be underscored by a statement of commitment by management and by the union, if any, and the application must be signed by the CEO of the applicant worksite to ensure a top to bottom approach.

Depending on the standard at which OSHA assesses an applicants OSH system, applicants enter the program at different levels and receive different benefits. Employers with exceptional programs receive special recognition including: the lowest priority for enforcement inspections, the highest priority for assistance, appropriate regulatory relief and penalty reductions of up to 100%. For those firms who are well intentioned but have room for improvement a sliding scale of incentives is offered.

The results:

- In 1991 of the 178 companies in the program, 9 sites had no injuries at all.
- Overall site's injury incidence rates were 55% below expected average for similar industries.
- 31 had no lost work-day injuries and overall the companies were 51% below expected lost workday injuries in similar industries, saving \$94 500 000 for 3500 lost work-days avoided.
- Costs only 1% of agency's entire fiscal budget.
- Many sites boast production improvements, reduced absenteeism and lower workers' compensation costs.
- For example, one company, Monsanto reduced its total recordable injury rate from 2.44 in 1989 to .50 in 1991. Lost workdays due to injuries went down from .93 to .12 and workers' compensation out of pocket costs went down from a million dollars to \$50 0000.

Some experts suggest that in order to work effectively VPPs need a lot of oversight by active unions who can respond when health and safety problems are not addressed. But 70% of VPP sites are non-union sites and these sites have devised ways to meaningfully involve employees without management domination but all parties agree that employee involvement and management commitment are the keys.

Source: Feitshans, Ilise with Oliver, Cathy (1997) "More than just a pretty program: OSHA Voluntary Protection Programs improve compliance by facing problems head on" *5 Corporate Conduct Quarterly* 69-73, 79; Gunningham, N. & Rees, J. (1998) "Industry self-regulation" forthcoming *Law & Policy*...

- The US EPA's policy on 'Incentives for Self-Policing: Discovery, Disclosures, Correction and Prevention of Violations' (effective from January 22 1996) is another example of a regulatory policy that provides incentives for high voluntary compliance even after a breach has occurred. It states that the EPA will refrain from recommending criminal prosecutions and forego 'gravity-based' (punitive) civil fines if a company voluntarily has reported and corrected environmental violations found either through an audit program (as defined in the policy) or through a satisfactory 'due diligence' program to prevent, detect, and correct violations.

- US OSHA's 'quick-fix' approach gives employers a 10% reduction for each violation immediately abated in the presence of the OSHA compliance officer.
- Another example is the State of Victoria in Australia where the EPA has provided the incentive of a more flexible permitting system for companies with an excellent environmental management system.

Box 13: Victoria's Accredited Licensee Permitting System

Amendments made to the Environment Protection Act 1970 (Vic) in 1994 allow companies to be freed from the standard prescriptive approach to works approval and licensing if they can demonstrate a high level of environmental performance and an ongoing capacity to maintain and improve that performance. In order to become an 'accredited licensee' a company must have:

1. an environmental management system;
2. an environmental audit program and
3. an environmental improvement plan.

The benefits for accredited licensees include:

- Ability for licensee to manage its own affairs without detailed regulatory prescription;
- A single system for the whole site;
- Works approval is not required except where there will be substantial changes to a process, or a major change to a discharge or emission;
- License fees will be reduced by 25% in recognition of lesser involvement by EPA personnel;
- Improved liaison and consultation with the local community.

Accountability is facilitated by virtue of the fact that the license must be subject to review at predetermined frequency not greater than five years. As at 3/2/97 five accredited licensees operating. There is also a requirement for community participation, consultation and access especially in relation to environment improvement plans. Continuation of the license is assessed on the basis of actual environmental performance and is judged against factors such as license compliance, implementation of environmental improvement plans and level of legal action (e.g. prosecutions).

In 1997 there were five accredited licensees, and in a review of the legislation some gave evidence that while the system is extremely beneficial, it works best for larger companies since smaller companies are not adequately equipped to tackle all the hurdles.

Sources: Environment Protection Authority (1993) *A Question of Trust: Accredited Licensee Concept. A Discussion Paper*, Environment Protection Authority, Melbourne, Victoria; Law Reform Committee (Victoria) (1997) *Regulatory Efficiency Legislation: Discussion Paper*, Parliament of Victoria, Melbourne, paras 2.23-2.28. .

58. Incentive and flexibility programs for encouraging high voluntary compliance may be usefully aimed at the particular compliance stresses faced by small businesses:

- For example, the US EPA's Office of Enforcement and Compliance Assurance's 'Policy on Compliance Incentives for Small Businesses' (effective June 10 1996) states that the EPA will refrain from initiating an enforcement action seeking civil penalties or will mitigate civil penalties whenever a small business makes a good faith effort to comply with environmental requirements by receiving compliance assistance or promptly disclosing the findings of a voluntarily conducted environmental audit. This is subject to the following conditions: that it is the first violation of the particular requirement, it does not involve criminal conduct, has not and is not causing a significant health, safety or environmental threat or harm and is remedied within the corrections period.

59. Another way that regulatory design can provide incentives for high voluntary compliance is by making directors and senior manager personally liable for non-compliance, but also providing that the existence of an effective compliance system will provide them with a defence or reduction of penalty. This makes the lack of an effective compliance system subject to a deterrent threat.

- Internationally the most significant development of this kind is the US *Federal Sentencing Guidelines* for organisations. These guidelines were promulgated by the US Sentencing Commission (which is made up of Judges) and was implemented by Congress. Companies with good compliance programs are given decreased fines when they commit an offence. Those that do not have in place a compliance program are placed on probation, until they implement one.

Box 14: *The US Federal Sentencing Guidelines for Organisations:*

A base fine is adjusted according to a corporation's 'culpability score'. Each corporation starts with five points on its culpability score. Judges must add points for aggravating factors and subtract points for mitigating factors. One of the major mitigating factors is that the organisation has in place an 'effective' compliance program. Depending on the final score, the actual fine may range from as little as one-twentieth to as much as four times the base fine.

The Guidelines recommend four conditions of probation that may be appropriate when the offending co-operation does not have an adequate compliance program: 1. Development and submission to the court of a compliance program, including a schedule for its implementation; 2. Notification to the company's employees and shareholders concerning its criminal behaviour and the compliance program prescribed by the court, 3. Periodic reporting to the court or probation officer and to applicable regulatory bodies on the company's progress in implementing the program, 4. Submission to regular or unannounced examinations of the company's records and "interrogation of knowledgeable company individuals" by the probation officer or "experts engaged by the court" to monitor whether the company is following its compliance program. This can involve direct oversight by regulators.

Results:

By mid-1995 208 organisations had been sentenced under the guidelines:

- Only one was found by the court to have an effective compliance program.
- Fourteen percent were ordered to implement compliance programs.
- Sixty-one percent were placed on probation.

However there is evidence that the Guidelines have had a significant impact on the implementation of compliance policies among US companies generally:

One survey of 262 US companies in 1996 found that:

- 86% had a formal compliance policy; 9% had one under development and only 5% had no policy.
- Slightly over half had a compliance policy in place before the Federal Sentencing Guidelines
- 14% modified their pre-existent compliance system or introduced a compliance program for the first time as a response to the Guidelines.
- 48% implemented a compliance policy for the first time partially because of the Guidelines.
- However larger companies were more likely to have implemented a compliance system earlier than smaller companies

Another survey of 300 US businesses found that:

- 20% adopted a compliance program for the first time in response to the Guidelines.
- 45% added vigour to their pre-existent compliance program because of the guidelines.

Sources: Harvard Law Review (1996) "Growing the carrot: Encouraging effective corporate compliance" 109 *Harvard Law Review*, 1783; Freyer, Dana (1996) "Corporate compliance programs for FDA-regulated companies: Incentives for their development and the impact of the Federal Sentencing Guidelines for Organizations" 51 *Food & Drug Law Journal*, 225-242; Price Waterhouse LLP, (1997) *1996 Survey of Corporate Compliance Practices*, Price Waterhouse, New York.

- Implementation of an effective compliance system can also be made a relevant factor in the assessment of director or senior management liability for organisational non-compliance. For example in the 1996 *Caremark* decision (*In re Caremark International Inc Derivative Litigation*, Del. Chancery C.A. 13670) the Delaware Chancery Court held that the Board's failure to establish and maintain an effective compliance program may render a director liable for losses caused by non-compliance with applicable legal standards. The suit alleged that the Board of Directors had breached their duty of care by failing to adequately supervise the conduct of the company's employees and therefore were responsible for the company's exposure to criminal and civil liability due to failure to comply with certain regulations.

E. Nurture Compliance Capacity in Business

60. Innovative regulatory strategies for encouraging compliance are not likely to be effective if organisations have no capacity or expertise in how to comply with regulation. Therefore one of the more strategic things regulators can do to increase compliance is to nurture organisational capacity to comply through education, assistance, offering consultancy services, and encouraging the growth of compliance professionals with specialist expertise in the area.

61. The nurture of compliance capacity should be a particular priority for improving compliance by SMEs since SMEs cause compliance stress due to their lack of capacity to comply:

- For example, US OSHA has specifically targeted compliance assistance to SMEs through its *OSHA Consultation* program: This is a broad network of occupational safety and health services funded primarily by federal OSHA but delivered by 50 state governments which provide a free source of information and technical assistance to employers who request help in establishing and maintaining a safe and healthful workplace. The comprehensive assistance available goes well beyond the minimum requirements of OSHA regulation and includes an appraisal of all mechanical systems, physical work practices and environmental hazards of workplace and all aspects of employer's present job safety and health program. The program exists primarily to assist SMEs (those with no more than 250 employees) in high hazard industries or involved in hazardous operations. In recent years the consultation program has helped identify and control more 500 000 workplace safety and health hazards.

A major selling point for SMEs is the government's willingness to pay for expert services that would otherwise could cost a small employer thousand of dollars. The consultation program is also completely separate from OSHA's inspection program and the consultant pledges confidentiality provided the employer agrees to correct in a timely manner any serious hazards uncovered during the consultation visit. In an independent survey conducted for OSHA in 1995, employers who had received onsite consultation visits indicated very high levels of satisfaction with the service provided and the knowledge and competence of OSHA consultants.²⁶

62. One very significant way in which compliance capacity can be increased in business is through the nurture of professionals who have the expertise to help companies to comply. These could include safety and environmental engineering as well as specialist compliance professionals in anti-discrimination (equal employment opportunity and sexual harassment), financial services and consumer protection.

²⁶ Weinberg, Judith 1996, "OSHA consultation: A voluntary approach to workplace safety and health compliance" 5(2) *Corporate Conduct Quarterly*, 21-24.

- In Australia, the Australian Competition and Consumer Commission has recognised the significance of nurturing compliance professionalism in increasing business compliance by being involved in the establishment of two professional associations for compliance professionals - the Society of Consumer Affairs Professional in Business and the Association for Compliance Professionals of Australia. These associations now run annual conferences and publish newsletters informing their members, who work within organisational compliance departments or in private consultancy practices on standards and ideas for high quality corporate compliance systems.

63. Some empirical evidence shows that flexible compliance-oriented programs are more likely to succeed where the regulated community includes compliance professionals who can act as a go-between between regulator and business so that business understands how to comply with regulatory goals and so that business can communicate ideas for more innovative and flexible regulatory mechanisms back to regulators. (See Box 15.)

Box 15: *The Contribution of Compliance Professionals to Increased Compliance*

Occupational Health and Safety:

An evaluation of the Californian branch of the US Occupational Safety and Health Administration (OSHA) experiment with the Cooperative Compliance Program between 1979 and 1984 found that the growth of *safety management professionalism* was crucial to compliance with regulatory goals. The program authorised labor-management safety committees on seven large construction sites to assume many of OSHA's regulatory responsibilities (such as conducting inspections and investigating complaints), while OSHA ceased routine compliance inspections and pursued a more co-operative relationship with these companies.

- During the program accident rates ranged from one third lower to five times lower than comparable company projects, and the satisfaction of workers, management and government participants with the program was high.
- The evaluation found that this approach succeeded mainly because it strengthened the pre-existent job site safety programs in ways that traditional regulatory strategies could not. The voluntary job site safety programs in turn had been promoted and implemented by safety management professionals, a professional specialisation promoted by the American Society of Safety Engineers. The existence of safety management professionals within the companies also allowed the labour-management and regulator-management communication necessary for the program to succeed.

Source: Rees, J. (1988) *Reforming the Workplace: A Study of Self-Regulation in Occupational Safety*, University of Pennsylvania Press, Philadelphia.

Affirmative Action:

An evaluation of compliance with the Australian affirmative action regime found that the degree of professionalism of equal employment opportunity (EEO) officers, especially their professional networking with other EEO professionals and with the EEO agency were positively correlated with procedural and substantive compliance with the requirements of the regulation.

Similarly in another study of corporate compliance with US civil rights laws, the author found that an important source of diffusion of due process protections was the professionalised practices of personnel officers and the establishment of personnel departments who saw compliance as part of their professional function and therefore provided a direct channel through which models of employee rights implementation could enter the organisation and created an internal constituency for the elaboration and enforcement of employee rights.

Source: Braithwaite, V. (1992) *First Steps: Business Reactions to Implementing the Affirmative Action Act*, A report to the Affirmative Action Agency, Australian National University, Canberra.; Edelman, L. (1990) "Legal environments and organisational governance: The expansion of due process in the American workplace" *95 American Journal of Sociology* 1401-1440.

2.4 Stage Three

F. Monitoring and Targeting For Low Compliance

64. The design of compliance-friendly regulation must be supplemented by compliance-oriented monitoring and enforcement of the regulatory system. One of the most significant developments in this area is a risk analysis-based approach to targeting monitoring of compliance: Regulators are beginning to decide when and where to do inspections by analysis of data on where risks of non-compliance are likely to be highest.

65. *Tiering* is an important tool for this task: Tiering refers to the tailoring of regulatory requirements to fit the particular circumstances surrounding regulated entities. It can be used in the substantive requirements of regulation and in reporting and record-keeping requirements. But it is particularly useful in developing policies for enforcement and compliance-monitoring. Since not all regulated entities can be monitored or inspected all the time, a rational system for deciding which to target when is very important. Regulatees can be tiered according to:

- Size: number of employees; operating revenues, assets, market share.
- Other factors: degree of risk; ability to comply; geographic location; level of federal funding.

66. There is evidence that tiering monitoring activities according to *size* has had significant effects in improving tax compliance. (See Box 16.)

Box 16: Tiering & Tax Compliance

A guiding principle behind many successful tax reforms has been that different size taxpayers require different administrative arrangements.

Large Taxpayers:

Since in many countries a small number of taxpayers contribute a large proportion of taxes collected, special units to monitor, audit and enforce collection for the largest taxpayers can yield significant results.

- In Uruguay, Bolivia and Sri Lanka where large taxpayers represent a high percentage of total tax collection, the percentage of stopfilers among the approximately 1000 largest taxpayers dropped from ten to one percent with the establishment of large-taxpayer units during the period from 1987 to 1991.
- In Argentina the Two Thousand Taxpayer System or DOS-MIL was established in 1991 to monitor the 900 largest taxpayers in the Buenos Aires metropolitan area. By 1994 it operated in approximately 130 tax offices throughout Argentina and covered about 2 450 taxpayers. During the period 1990-1994, VAT collection rose from 2.1% of GDP to 6.3% of GDP, an increase partially attributable to these reforms.

Medium-Sized Taxpayers:

- In Uruguay the monitoring of 5000 medium-sized taxpayers with a new computer system beginning in 1990 resulted in a 22% real increase in taxes collected from this group in the same year.
- In Paraguay the use of new systems with 1000 medium-sized taxpayers resulted in a 36% increase in real tax collection from 1994-1995 for this group, and 22% increase in total revenue.

Source: Silvani, Carlos & Baer, Katherine (1997) "Designing a tax administration reform strategy: Experiences and guidelines: A working paper of the International Monetary Fund" 15(5) *Tax Notes International*, 375-395.

67. A number of British financial regulators have developed quite sophisticated models for tiering regulatory and inspection requirements for financial institutions according to assessments of *risk*.

- For example, the Investment Management Regulatory Organisation (IMRO; a front line regulator recognised by the Financial Services Authority in England) uses the *Relative Risk Assessment Model* to determine the degree of risk to investors that a firm may generate. The assessment is based upon :
 - ⇒ the inherent risks of the products sold or managed by the firm,
 - ⇒ the capital base of the firm,
 - ⇒ the experience and ability of the management and staff of the firm and
 - ⇒ the attitude of the firm towards investor interest and compliance issues including the standard of the firm's compliance system.

Firms are rated on a three point scale solely for IMRO use and their rating is used to determine how frequently IMRO inspectors visit firms and how closely they monitor their activities. A pilot study of 50 organisations rated in the first level who have been given less onerous regulatory responsibilities has been very successful.²⁷

The potential disadvantages of tiering include:

- increased complexity for agency programs;
- increased inconsistency and confusion;
- delay in the regulatory design process;
- legal constraints such as statutory conflict or questions of constitutionality may limit the availability of tiering as a regulatory mechanism.

G. Restorative Justice When Voluntary Compliance Fails

68. Compliance-oriented regulation is aimed at providing incentives and encouragement to voluntary compliance and nurturing the ability for private actors to secure compliance through self-regulation, internal management systems and market mechanisms where possible rather than automatically using punishment for breaches of the rules as the first regulatory tool. When organisations do fail to comply in the first instance, a compliance-oriented regulatory approach will attempt to *restore* compliance rather than reverting immediately to a purely punishment-oriented approach.

69. In criminal process restorative justice requires an offender is required to confront his/her responsibility for wrongdoing by facing his/her victim/s and together resolve how to put the wrong right (for example by paying restitution or doing community service) dialogue about how to solve the problem. Restorative justice gives the offender a chance to put his/her wrong right and to be restored back into full citizenship in the community upon doing so. The aim is not only to provide a better remedy and healing for the victim than imprisonment or a fine would provide, but also to help transform the offender to a more law-abiding person in the future. This is often achieved by enlisting the support of members of the both victim's and offender's families and communities to support victim and offender in the restorative process.

70. A number of business regulators have experimented with innovative mechanisms for *restorative justice* when compliance fails, in order to remedy the wrong and ensure compliance in the future. While the evidence on the effectiveness and fairness of restorative justice for *individual* offenders is still being evaluated, there is good evidence that the restorative justice approach is an effective approach to *corporate* law-breaking.²⁸ (See Box 17.)

²⁷ IMRO 1997, *Regulatory Plan 1996-1997*.

²⁸ Braithwaite, J. forthcoming, "Restorative justice: Assessing an immodest theory and a pessimistic theory" *Crime and Justice - A Review of Research*.

Box 17: Successful Uses of Restorative Justice in Business Regulation

Coal Mine Safety:

One study found that in the UK the mines with the best safety records are those that thoroughly include everyone concerned (workers, management) after accidents and near-accidents to reach consensual agreement on what must be done to prevent recurrence of the accident or near-accident and discussed safety results with workers even when there was no near accident.

Nuclear Power Safety

Another example of the success of restorative justice processes in regulating safety is the Institute of Nuclear Power Operators (INPO), a US self-regulatory organisation to regulate nuclear utilities which was set up after the Three Mile Island accident to develop standards, conduct inspections and investigate accidents. Safety has increased significantly since Three Mile Island across a number of indicators including data that shows that scrams (automatic emergency shutdowns) per unit have declined in the US from seven per unit in 1980 to one in 1993. One of the restorative regulatory mechanisms that has contributed to this success is meetings in which senior nuclear officials from all companies meet together and three vice-presidents give a detailed explanation of a recent accident at their utility and what went wrong:

- More than a detailed explanation of an accident, it also involves 'baring your soul and telling all to your peers (people that you know) that you screwed up,' explains an INPO official. 'You know, I'm not a Catholic, but it's probably like going to confession. In the end you'll feel better, but when you're there it's pretty difficult.' ... Within an ongoing relationship sustained by close ties (whether a family or occupational community), wrongdoing arouses the disapproval of a significant other (whether a parent or professional peer), thus invoking a sense of remorse and repentance in the wrongdoer, which leads to reacceptance (reintegration) by the significant other. Wrongdoing, shame and reintegration - that distilled to its essence, is the family [restorative] model of social control.

Nursing Home Regulation

A cross-country evaluation of nursing home regulation and inspections has also found significant evidence for the effectiveness of restorative justice mechanisms in controlling organisational wrongdoing. For example in one part of the study, one dimension of the level of restorative justice used in the post-inspection conference held to discuss the inspection findings in 242 Australian nursing home inspections was measured. The levels of compliance found in that inspection and in the next inspection 18 to 24 months later were then compared.

Where the inspection team had used restorative justice (i.e. they clearly disapproved breaches of the rules but also terminated disapproval by pointing to something positive or offering praise for moving to fix that which was disapproved) *non-compliance was reduced by 39%* between the first and second visits.

- Where inspection teams used purely negative and punitive approaches and did not also offer praise and forgiveness, non-compliance increased by 39%.
- Where inspection teams were purely tolerant and understanding, but did not make clear their disapproval for breaches of the rule non-compliance either increased or stayed the same.

The authors of the study concluded that:

- [T]he most stigmatic inspectors manage to effect significant reductions in the compliance of the nursing homes they inspect. At the same time, tolerant and understanding inspectors who believe in saying nice things at all times are almost as ineffective. This is because these tolerant and understanding inspectors fail to express disapproval when the standards set down in the law are not met. The effective inspectors are those who believe in strong expressions of disapproval combined with strong commitments to burying the hatchet once such robust encounters are over, to terminating disapproval with approval once things are fixed, to tempering disapproval for poor performance on one standard with approval for good performance on other standards, to avoiding humiliation by communicating disapproval of poor performance within a framework of respect for the performer.

Sources: Braithwaite, J. (1985) *To Punish or Persuade: Enforcement of Coal Mine Safety*, State University of New York Press, Albany, p67; Rees, J. (1994) *Hostages of Each Other: The Transformation of Nuclear Safety Since Three Mile Island*, University of Chicago Press, Chicago and London, pp. 106-107; Makkai, T. & Braithwaite, J. (1994) "Reintegrative shaming and regulatory compliance" 32 *Criminology*, 361-385.²⁹

²⁹ Measurements of a number of other dimensions of restorative justice were made in other papers from the same study e.g. Makkai, T. & Braithwaite, J. 1993, "Praise, pride and corporate compliance" 21 *International Journal of the*

71. The Australian Competition and Consumer Commission's approach to settling alleged breaches of the competition and consumer protection law, utilises a restorative justice element that gives companies a chance to put the alleged wrongdoing right, implement a compliance system to ensure it does not happen again and engage in some form of public service to educate others in their industry.

- The Australian Competition and Consumer Commission (ACCC) is authorised to accept an undertaking by a company in settlement of an alleged breach that remedies the wrong and ensures that it will not happen again, rather than pursuing punitive enforcement action. A basic undertaking includes:
 - ⇒ a commitment to cease the conduct;
 - ⇒ mechanisms for corrective action such as compensation, reimbursement or corrective advertising;
 - ⇒ a program to improve overall compliance with the Act (certain standards for compliance programs have been promulgated by the ACCC);
 - ⇒ provision for the order to become a matter of public record and to be publicised in news media statements;
 - ⇒ community service orders such as development and implementation of industry wide compliance education programs and publication of material dealing with the undertaking in relevant trade journals.

The undertakings or settlements are kept on a public register and in the event of non-compliance the ACCC can apply to the Federal Court for enforcement and appropriate orders.

Since 1993 there has been a steady growth in the use of s87B undertakings, with 15 in 1993, 34 in 1994, 68 in 1995, 58 in 1996 and 37 to mid-1997. While the early undertakings focused simply on stopping and preventing the particular conduct in question, requiring corrective advertising and the implementation of a general trade practices compliance program, later and more sophisticated undertakings can be up to 20 or 30 pages long and specify the standards for compliance programs and consumer complaint handling systems to be put in place. In one case, for example, a company was required to recognise that the alleged breaches were caused by inequalities in bargaining power between it and its suppliers. In response it undertook to help the ACCC draft a dispute resolution code of conduct for disputes between large companies and suppliers or small businesses. It also undertook to change its own standard contracts to incorporate compliance with the new code.³⁰

H. Tit For Tat Enforcement When Restorative Justice Fails

72. Restorative justice, of course, must always be backed up by the possibility of more punitive sanctions. Indeed the evidence shows that persuasive and compliance-oriented enforcement methods are more likely to work where they are backed up by the possibility of more severe methods.

Sociology of Law, 73–91; Makkai, T. & Braithwaite, J. 1994, "The dialectics of corporate deterrence" 31 *Journal of Research in Crime & Delinquency*, 347–373.

³⁰ Source: Parker, C. 1999 "Evaluating regulatory compliance: Best practice and standards", *Trade Practices Law Journal*, forthcoming.

- For example, in one study UK mine safety regulatory inspectors who used persuasive restorative strategies to promote compliance were more effective if persuasion was backed up by the possibility of punishment.³¹

73. The idea is that regulators should engage ‘tit for tat’ in restorative or persuasive enforcement strategies depending on the responses of the regulated entity. A regulator can start with persuasive or restorative strategies and then move to more punitive strategies if voluntary compliance fails. If the application of punitive sanctions succeeds in bringing about compliance then the regulator can revert to a trusting demeanour. If it does not bring about compliance, then the regulator must invoke harsher sanctions. The wider the range of strategies (from restorative to punitive) available to the regulator, the more successful tit for tat enforcement is likely to be.

74. This principle has been demonstrated in the idea of a pyramid of enforcement strategies (see Figure One). The pyramid is a schematic representation of the idea that instead of using their most drastic regulatory strategies first, regulators should trade on the goodwill of those they are regulating, encouraging them to comply voluntarily, using more drastic regulatory measures only when that fails and reverting to a trusting demeanour when these strategies achieve their goal: ‘Compliance is optimised by regulation that is contingently co-operative, tough and forgiving’.³² In this model prioritising restorative, compliance-oriented means of regulation in time ensures that co-operative, voluntary measures are used more frequently without compromising the possibility of using harsher measures where necessary.

³¹ Braithwaite, J. 1985, *To Punish or Persuade: Enforcement of Coal Mine Safety*, State University of New York Press, Albany.

³² Ayres, I. & Braithwaite, J. 1992, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, New York, p51.

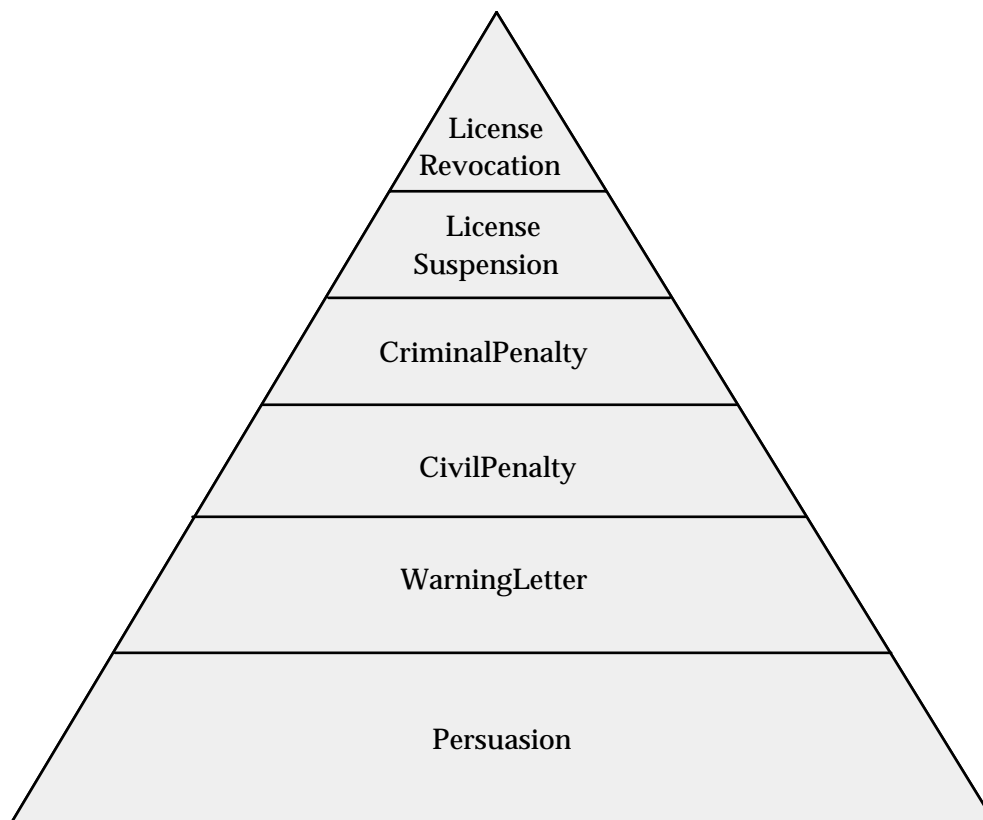


Figure One An Enforcement Pyramid for Business Regulation
(Source: Ayres, I. & Braithwaite, J. 1992, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, New York, p35)

3. PERFORMANCE MANAGEMENT ISSUES FOR REGULATORY AGENCIES AND ISSUES FOR FURTHER RESEARCH

75. Taking a compliance-oriented approach to regulatory design will have wide-reaching ramifications for their own performance management by regulatory agencies. This section outlines four ways in which regulatory agencies may need to change their own internal arrangements and performance management.

3.1 Develop Information Capability To Monitor Compliance Trends, Identify and Prioritise Problems and Evaluate Solutions.

76. In the past governments and regulators have not been oriented towards managing regulation by reference to compliance outcomes or the achievement of social and economic benefits promised by regulation. Therefore few have consistently collected data on compliance levels or assessed the effects of regulatory interventions on social phenomena over time (e.g. environmental results, health effects, decline in injury rates). Instead regulatory management has concentrated on collecting statistics focused on regulatory agency activities and outputs (e.g. enforcement actions, inspections, education and outreach). However compliance-oriented regulation requires knowledge of compliance trends so that governments and regulators can identify and prioritise problem areas, and evaluate whether regulatory solutions have had the desired effect.

77. Reliable data on compliance trends over time is very difficult to collect for the following reasons:

- ⇒ Existing statistics on regulatory actions such as enforcement and inspections are an inadequate basis for drawing conclusions about compliance trends because compliance rates cannot be derived from a focused or biased inspection program and almost all current enforcement and/or inspection programs are necessarily focused, biased or not comprehensive for practical reasons.
- ⇒ Regulatory inflation (growth in amount of regulation) and regulatory instability (changes in regulation) make it extremely difficult to draw conclusions about compliance trends over time: Actions or behaviours that were legal at one time become illegal at another so that the compliance goal post is continuously moving. Perceptions that rates of compliance are decreasing may reflect the fact that the amount or unpredictability of regulation is increasing over time, rather than that business is doing less to comply over time. It is possible that business compliance is increasing but that regulation is increasing or changing at an even greater rate, leaving a 'compliance lag' that creates the impression (but not necessarily the reality) of less compliance.
- ⇒ Governments and regulators also face a host of technical problems with measuring regulatory impacts or effects: Impact measures are problem specific and therefore difficult to aggregate into overall compliance trends. Causality is usually impossible to prove and disaggregate from the effects of other factors (such as general economic conditions). The difficulty of measuring things that did not happen makes it particularly difficult to measure the impacts of regulations that prohibit or are aimed at preventing undesirable events.

78. Overcoming these problems and developing more effective ways of measuring compliance trends and regulatory impacts will have to be the focus of further work if governments are to undertake effective regulatory management. (See Box 18.)

Box 18: Information: The Key to Effective Regulation

The Canadian Regulatory Compliance Project concluded that information is the “key to effective regulation”:

Every regulatory regime should have effective administrative systems for operational planning, ongoing management, and a periodic review of compliance-related activities. Planning allows the program to monitor changing conditions, identify priorities, modify the compliance strategy (if required), and assign resources for maximum efficiency and effectiveness. Ongoing management is necessary to keep things on track and allow for adjustment if circumstances change. A periodic review will assess how well program management and operational staff have done, and determine appropriate adjustments for all aspects of the program, including the legislation.

The key to all these functions is a good system which provides the required information to management and operational staff. The hardware aspects of the management information system are far less important than the question of what information is needed to do the job properly. Information requirements may be significantly influenced by the overall strategy adopted by the program, and by the detailed requirements of the compliance policy.

For instance, a program of planned audit and inspection activities cannot be sensibly developed by management without accurate information on the most critical problems or types of violations. If the compliance policy stipulates that the compliance history of a regulated group member is relevant in determining the appropriate response to a violation of the law, field staff cannot possibly make fair and consistent decisions unless they have this information available—preferably on a national basis where companies deal in more than one province or region.

Management will have no idea if the legislation is being administered or enforced in accordance with the compliance policy unless they can obtain information about the violations discovered and the action that was taken.

Quoted from Regulatory Compliance Project (Department of Justice) 1992, *A Strategic Approach to Developing Compliance Policies*, Government of Canada.

3.2 Evaluate Performance of Regulators by Reference to Compliance Outcomes

79. It is possible to evaluate the performance of regulatory agencies by reference to several different factors:

1. Effects/Impacts/Outcomes: For example environmental results, health effects, decline in injury rates;
2. Behavioural Outcomes: Compliance rates or other outcomes (e.g. adoption of best practice, other risk reduction activities, “beyond compliance” activities, voluntary actions);
3. Agency Activities/Outcomes: For example enforcement actions; inspections (number, nature, findings); education/outreach; collaborative partnerships; administration of voluntary programs; other compliance-generating or behavioural change inducing activities;
4. Resource Efficiency: With respect to use of agency resources; regulated community resources; state authority;³³
5. Transparency: Compliance activities must be carried out transparently and in an accountable fashion to ensure honesty, neutrality and efficiency of application.

80. Traditionally performance measures for regulatory agencies have clustered around the measures in category 3. Regulatory quality management broadens performance measures to category 4 and a

³³ The last four features are from Sparrow, M. 1996, “Regulatory Reform: Lessons from the Innovations Awards Program” Mimeo, John F. Kennedy School of Government, Harvard University.

compliance-orientation requires that category 3 and 4 performance measures be supplemented by category 1 and 2 performance measures. For example Box 19 demonstrates how the US EPA has begun to experiment with measuring its own performance in a more compliance-oriented way.

Box 19: *Evaluating Regulatory Agency Performance in a Compliance-Oriented Way*

Until fiscal year 1996, the US EPA counted annual enforcement outputs (e.g. inspections conducted, number of civil and criminal cases, penalties assessed) as the predominant measure of performance for the enforcement and compliance assurance program. The EPA has now begun to experiment with additional measures to assess the status and trends of regulatory compliance, as well as environmental improvements resulting from enforcement and compliance assurance activities through:

- 1) Convening a measures of success work group;
- 2) Case conclusion data sheet to gather new types of information about completed cases;
- 3) A reporting measure for compliance assistance activities; and
- 4) Realigning single-media databases to enable repositioning of enforcement data by industry sector.

Supplemental evaluative measures included in the agency report for fiscal year 1996 included:

- 1) Actions taken by violators to return to compliance;
- 2) Quantitative environmental impact and qualitative environmental benefit of those actions;
- 3) Types, amounts and impact of compliance assistance activities; and
- 4) Industry-specific compliance rates.

Source: Geltman, Elizabeth & Skrobback, Andrew (1998) "Reinventing the EPA to conform with the new American environmentally" 23 *Columbia Journal of Environmental Law* 1-56, p22.

3.3 Develop Capacity to Meta-Evaluate Voluntary Compliance by Regulatees

81. Compliance-friendly regulatory innovations frequently rely on encouraging voluntary compliance in industry, but regulatory agencies must continue to monitor the extent and quality of voluntary compliance. This means developing the capacity to evaluate compliance at one remove, without becoming so involved in monitoring that the advantages of a policy of relying on voluntary compliance is lost.

82. Australia is the only place where a comprehensive set of generic standards for compliance programs have been agreed upon and codified in a standard - the Australian Standard on Compliance Programs (AS3806). (See Box 20.)

Box 21: The Australian Standard for Compliance Programs - AS3806-1998

The Australian Competition and Consumer Commission together with the Association for Compliance Professionals of Australia developed the standard under the processes of Standards Australia with representatives from the Australian Institute of Criminology, the Consumers' Federation of Australia, the Federal Bureau of Consumer Affairs and the Public Interest Advocacy Centre.

AS3806 divides the requirements for a compliance program into 'structural, operational and maintenance elements', and contains an appendix specifically addressing compliance for small business.

The *structural elements* of the compliance programs should include not only a written statement of the organisation's compliance policy and how it will be carried out, but also commitment to effective compliance from the Board and senior management of an organisation down through all levels of the organisation. All managers should understand, promote and be responsible for compliance and adequate resources should be made available for this task. The standard makes a point of seeing adequate compliance staff as a significant resource for compliance and of saying that the professional integrity and ability of those staff should be protected and nurtured by ensuring they have high status and authority, access to all levels of the organisation including senior decision makers and a record of integrity and commitment to compliance, as well as the skills necessary to implement behavioural and procedural controls.

The *operational elements* set out how to actually implement a compliance program by firstly identifying the compliance issues that are likely to be raised by a particular organisation's organisation and operation, secondly creating ways for integrating compliance into day to day operating procedures, and then training staff to implement it, ensuring managers supervise it and enforcing its implementation at every level. An operational compliance system also requires an adequate system for handling complaints and identifying compliance failures and rectifying them, including identifying any systematic or recurring problems and rectifying them at structural level if necessary. Finally, the components and implementation of the program needs to be systematically recorded and failures and problems and their rectification should be internally reported to compliance managers, and ultimately to senior management.

Thirdly, the standard provides that the company should ensure the compliance program is *appropriately maintained* through practical education and training for staff at induction and on an ongoing basis, through regularly publicising and communicating the organisation's commitment to compliance and relevant compliance issues to staff and liaising regularly with regulatory authorities and community groups to keep up to date with compliance issues. Most significantly, the program must also be monitored, assessed and reviewed to ensure its effectiveness and the organisation should be made accountable for the effectiveness of the program by reporting on the operation of the compliance program against performance standards (which could include AS3806 itself).

83. The existence of a generic standard for compliance means that companies can now choose to be independently audited for compliance with the standard. Some Australian companies have already begun to pioneer the monitoring of the effectiveness of their own compliance systems and even reporting and auditing of their results. For example car insurance company AAMI, has introduced a scheme of publishing an annual independent audit of its performance in meeting the objectives of its 'consumer charter'. The consumer charter sets out AAMI's standards of customer service and promises payment of a \$25 penalty to any customer who does not receive the service promised. The performance of the company in relation to the Charter is audited each year by KPMG.

84. Regulators could meta-evaluate corporate compliance by checking that audits have been done. What little data are available on corporate compliance programs tell us that this is one of the weak spots in current corporate compliance programs:

- A survey of US corporate compliance programs in 1983 that audits were under-utilised.³⁴
- A 1991 study of compliance efforts at more than 700 US companies found that 45% had no ethics auditing systems.³⁵

85. Regulators could enforce the procedural requirement that companies audit, review and continuously improve the performance of their programs according to standards like AS3806.

- For example, recent undertakings under the Australian *Trade Practices Act* require the companies to report their own progress in implementing compliance systems, or to have their progress audited and reported to the Australian Competition and Consumer Commission at certain intervals.

3.4 Nurture Capacity for Regulatory Partnerships Across Public-Private Divides and Between Governments/Public Agencies

86. Compliance-friendly regulatory innovation requires imaginative solutions to problems that cross traditional disciplinary and departmental boundaries. Therefore regulators need to develop the capacity to work in partnership with other agencies both public and private in non-traditional ways by .

1. Recognising potential allies in the private sector
2. Not allowing conventional government/departmental boundaries to get in the way of solutions.

87. One formal way in which the necessity of strategic co-operation between different regulatory agencies is necessary to ensure compliance is in the Norwegian internal control systems regulation. (See Box 21)

³⁴ Beckenstein, A. & Gabel, H. 1983, "Antitrust compliance: Results of a survey of legal opinion" 51 *Antitrust Law Journal*, 459-516.

³⁵ J. Kaplan, "The corporate sentencing guidelines: Making compliance programs 'effective'" (1991) 1 *Corporate Conduct Quarterly* 1.

Box 21 Compliance-Oriented Co-ordination Between Regulatory Agencies in Norway:

The internal control regulations (1992) was introduced by the Norwegian government as an aid to improving the co-ordination of the different supervisory agencies for laws covering environment, health and safety. It is a joint initiative of the Ministry of Environment, Ministry of Justice, Ministry of Local Government and Ministry of Children and Family Affairs. It applies to all private and public organisations who employ people and requires them to establish and maintain a control system for environmental, health and safety work. They are required to apply a systematic approach to ensuring compliance with all the requirements laid down in relations relating to worker protection and work environment, flammable goods, explosives, fire prevention, waste management and protection against pollution, product control, civil defence and the inspection of electrical installations and equipment. It requires co-ordination between the labour inspectorate, directorate for fire and explosion prevention/municipal fire board; the electricity inspectorate; the national pollution control agency; the ministry of children and family, section for product safety and local county councils.

The internal control regulations require corporations to have as a minimum written descriptions for the following aspects of the business: the management's objectives for the EHS activities of the enterprise; organisational diagrams with responsibilities for EHS work and references to job instructions; routines and procedures for ensuring that the enterprise complies with the laws, including descriptions of who is responsible for auditing, the implementation of corrective actions taken and the follow-up of these; procedures for the systematic maintenance and revision of the internal control system and how it is secured that all persons needing the information about changes are given this information.

The internal control system was originally developed and used for offshore activities, where it played a significant part in the improvement of environment, health and safety after some major accidents with severe environmental impacts.

Source: Andersen, Otto 1996, "The Norwegian internal control system: A tool in corporate environmental management?" 3 *Eco-Management and Auditing*, 26-29.

3.5 Other Directions for Further Work

88. The capacity to engage in compliance-friendly regulatory design and implementation is crucial to accomplishing regulatory goals in an effective and efficient way. Greater understanding of compliance trends (both stresses and successes) and further evaluation of compliance-oriented regulatory innovations across different countries should be an important part of the continuing agenda of the management and reform or regulatory systems.

89. Some ways in which OECD countries could cooperate to achieve these goals are:

- In order to develop a more complete picture of compliance trends (stresses and successes), OECD countries could be asked to collect and report data on achievement of regulatory goals and compliance outcomes. This would allow us to draw comparisons between the achievements under different types of regulatory regimes in different countries as well as better identifying the global stresses that need most attention and, perhaps, more co-operation between OECD countries to deal with.
- In addition countries could report on their experiments in compliance innovation in regulatory design and implementation, and report the results of any evaluations of these experiments. This would encourage some public agencies to rigorously evaluate some of their compliance-oriented experiments and for good models to be more swiftly diffused to other countries. Evaluative data from other countries would also help governments avoid regulatory projects that sound good in theory but are unlikely to work in practice. Of course cultural factors in different countries mean that similar regulatory designs may have quite different impacts in different countries.

- An additional way of collecting data on cross-national compliance trends and the impact of regulatory innovation would be through a cross-national survey of a random sample of business people and members of the public.
 - ⇒ An opinion survey of business people could assess factors such as their level of understanding of particular regulatory requirements; their belief the value and practicability of compliance with particular regulatory requirements; whether they had experienced any benefit from policies of regulatory flexibility; what their estimated costs of compliance have been in the previous two years; to what extent they have implemented formal compliance systems and hired specialist staff to assist in compliance; whether they had experienced any enforcement actions against them in the previous two years and how they responded to them.
 - ⇒ An opinion survey of the general public could assess factors such as public confidence in particular regulatory systems; perceived levels of compliance with regulatory requirements and perceived compliance stresses and successes.

Cross-national data such as this would use the world as a laboratory in which a variety of different styles of regulation in different countries could be compared. The resulting data would be extremely useful for all countries in comparing the accomplishments and weaknesses of different types of regulatory systems.

- Finally the data and experiences from OECD countries on the evaluation of compliance-oriented regulatory innovation would be an excellent basis for development of a set of principles on designing compliance-friendly regulation for national governments could use as a tool in assessing and designing regulatory systems. This would build on the attempts in Canada and the Netherlands to develop regulatory management principles that make the accomplishment of compliance central, and would underscore the fact that regulation and regulatory reform is useless unless it contributes to the actual achievement of regulatory goals through compliance.

ANNEX ONE: SUMMARY OF STUDIES ON IMPLEMENTATION OF CORPORATE COMPLIANCE PROGRAMS

Author & Year	Ward/Price Waterhouse (1997)	Weinberger (1990)	Braithwaite (1993)	Still (1997)	Andersen (1996)
Country	United States	United States	Australia	Australia	Norway
Sample	5000 companies	27 Missouri based top 1000 US companies	All companies reporting to Affirmative Action Agency	Top 75 financial institutions reporting to Affirmative Action Agency	100 top corporate managers
Response Rate	262	74%	100%	100%	100%
Findings	<p>86% had a formal compliance policy 9% were developing a policy 5% had no policy</p> <p><i>The top eight areas covered by compliance programs were:</i> Ethics, conflicts of interest & gifts (86%) Employment/labour law (75%) Antitrust, trade regulation & procurement (68%) Environmental, health and safety (65%) Lobbying, government relations and political contributions (60%) Securities law (55%) Intellectual property (52%) International business practices (46%)</p>	<p>70% had implemented formal policy re insider trading</p>	<p>86% issued affirmative action policy to all staff. 70% set objectives for affirmative action progress for year ending 1990.</p>	<p>87% management actively promote workplace free of sexual harassment. 81% formal procedures in place to deal with complaints of sexual harassment.</p>	<p>31% strongly engaged in environmental, health & safety (EHS) work. 37% medium to strongly engaged in EHS work. 32% not interested in implementing EHS actions. 29% companies with sales up to 10 mill NOK had no knowledge of requirement for EHS system. 6% companies with sales over 100 mill NOK had no knowledge of requirement for EHS system.</p>

