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REGULATORY DARK MATTER:

HOW UNACCOUNTABLE REGULATORS SUBVERT DEMOCRACY BY IMPOSING RED TAPE WITHOUT TRANSPARENCY

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Kurt Wallace, Research Fellow

CUT RED TAPE TO
UNLEASH PROSPERITY

 **Institute of
Public Affairs**

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Executive Summary

Red tape is the single biggest barrier to economic prosperity and opportunity in Australia. Each year red tape reduces economic output by \$176 billion, which is around 10 per cent of GDP.¹ Red tape is undermining Australia's international competitiveness. For example, Australia is ranked 77th out of 140 countries for the burden of government regulation by the World Economic Forum.²

Red tape is in turn a key reason why new private sector business investment is just 11.5 per cent of GDP, which is lower than it was during the Whitlam-era. Low levels of business investment are a key cause of sluggish productivity growth and slow wages growth.

For the first time in Australia this report analyses and develops a methodology for measuring a category of red tape that to date has been ignored. This category of red tape is described as 'regulatory dark matter' which refers to publications by government agencies that seek to influence the behaviour of regulated actors (such as businesses) but lack adequate democratic oversight. These publications are not necessarily bound by law, but nonetheless have a regulatory effect which results in a greater red tape burden faced by individuals and businesses.

'Regulatory dark matter' is defined as "regulatory actions taken by departments and agencies that are subject to little scrutiny or democratic accountability." This broad definition includes two commonly used categories in the Australian context: legislative instruments and quasi-regulation. Regulatory dark matter, particularly quasi-regulation, is also often referred to as "soft law" in the Australian context.

To present a snapshot of the problem of regulatory dark matter this report looks at five government agencies in the banking and finance sector. The agencies included are the Australian Security Investment Commission (ASIC), the Australian Prudential Regulation Authority (APRA), the Australian Competition and Consumer Commission (ACCC), the Australian Accounting Standards Board (AASB), and the Auditing and Assurance Standards Board (AUASB). This report focusses on the financial sector as it is a sector which has been growing rapidly over the past two decades, is the largest in the developed world as a percentage of GDP, and has been subject to a range of government inquiries the most recent of being from the Banking Royal Commission.

From these five agencies there are 75,976 pages of regulatory dark matter currently in place, including 19,011 pages of legislative instruments, while quasi-regulation (such as guidance material) added 56,965 pages. For purposes of comparison, regulatory dark matter is more than 52 times greater than Tolstoy's famous *War and Peace* and eight times larger than the original enabling legislation for these agencies passed by Parliament.

1 Mikayla Novak, *The \$176 Billion Tax on Our Prosperity* (Institute of Public Affairs: May 2016) accessed 6 May 2019, <https://ipa.org.au/wp-content/uploads/2016/12/The-176-Billion-Tax-On-Our-Prosperity.pdf>.

2 Klaus Schwab, *Global Competitiveness Report 2018* (World Economic Forum: 2018), accessed 6 May 2019, <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>.

For every page of enabling legislation passed by Parliament, there are another eight pages of regulation imposed on the Australian economy by the regulatory state. This 8-to-1 ratio of “dark” to “light” regulation is a concerning aspect of the red tape burden. While regulation passed by Parliament is subject to a transparent democratic process, regulatory dark matter is being imposed by the regulatory state with little democratic oversight.

Examining regulatory dark matter for these agencies that affect the banking and financial sectors provides an example of the kinds of materials that are classified as regulatory dark matter and sheds light on the practices of agencies that increase the red tape burden.

Key Findings

- The volume for regulatory dark matter is eight times that of underlying enabling legislation. This means that for each page of regulation passed we can expect, on average, another eight pages will be implemented by government agencies.
- There are 75,976 pages of regulatory dark matter currently in place out of the five sampled agencies in the finance and banking sector. This is compared with *War and Peace* which is 1,440 pages and the underlying enabling legislation for these agencies which is 9,524 pages.
- The Australia Consumer and Competition Commission imposed the largest amount of regulatory dark matter with some 44,160 pages currently in place (60 per cent of the total).
- Regulatory dark matter is inherently undemocratic. Government agencies are able to impose new conditions on business with little to no parliamentary oversight.
- Regulatory dark matter adds to the already substantial red tape burden on the Australian economy, which reduces economic output by \$176 billion each year which is the equivalent to 10 per cent of GDP.
- Red tape is the key reason why business investment is just 11.5 per cent of GDP, which is lower than it was during the anti-business Whitlam-era. Low business investment is a key contributing factor to sluggish productivity growth and correspondingly slow wages growth.
- Regulatory dark matter stunts competition. Smaller businesses are less able to keep up with the ever growing body of regulatory activity, which undermines their ability to compete against larger incumbent businesses.

Introduction

Research by the Institute of Public Affairs estimated that red tape costs the Australian economy \$176 billion every year, with modelling using data on executive perceptions of the regulatory burden.³ The IPA has also outlined the problem of increased levels of regulation by counting the amount of primary and secondary legislation passed each year along with the number of pages of legislation.⁴

Another method of measuring red tape is to count the number of restrictive clauses contained in regulation. This method has been used to great effect in British Columbia in Canada, and also briefly in Queensland under the Newman government.⁵ The Coalition government used a cost of compliance measurement as part of its 'deregulation agenda'.⁶

One area of the red tape burden that has been overlooked by various measurements is the level of quasi-regulatory documents published by departments and agencies that lack official legal status but none the less have strong restrictive effects in practice. This report includes these publications that lack adequate democratic oversight as part of 'regulatory dark matter'.

Like dark matter that doesn't emit light and cannot be seen, regulatory dark matter often goes undetected and lacks "disclosure, supervision, and transparency."⁷ Wayne Crews from the Competitive Enterprise Institute has developed the concept attributing the problem to the over-delegation of legislative power.⁸

The definition used for regulatory dark matter is; "Regulatory actions taken by departments and agencies that are subject to little scrutiny or democratic accountability." The first section considers how the threefold distinction between legislation, legislative instruments, and quasi-regulation fits with this definition of regulatory dark matter.

The second section presents a snapshot of the problem of regulatory dark matter by providing a count of pages from five agencies that operate in the banking and finance sectors. The red tape implications of regulatory dark matter are then considered with proposals for how to reduce the burden of regulatory dark matter on the economy.

3 Novak, *The \$176 Billion Tax on Our Prosperity*.

4 Daniel Wild, *Reducing Red Tape in Australia: 'One In, Two Out' Rule* (Institute of Public Affairs) accessed 6 May 2019, https://ipa.org.au/wp-content/uploads/2017/05/IPA_Report_Reducing_Red_Tape_In_Australia_One_In_Two_Out_Rule_170504.pdf.

5 Laura Jones, *Cutting Red Tape in Canada: A Regulatory Reform Model for the United States?* (Mercatus Center: November 2015) accessed 14 May 2018, <https://www.mercatus.org/system/files/Jones-Reg-Reform-British-Columbia.pdf>. Darcy Allan, "Red tape reduction: A new approach," in *Australia's Red Tape Crisis*, ed. Chris Berg and Darcy Allan (Melbourne: Connor Court, 2018).

6 Australian Government, "Annual Regulatory Reform Report: 1 January 2016 – 30 June 2017," accessed 6 May 2019, https://docs.jobs.gov.au/system/files/doc/other/annual_regulatory_reform_report_1_january_2016-30_june_2017-final.pdf.

7 Clyde Wayne Crews Jr., *Mapping Washington's Lawlessness 2016*, (Competitive Enterprise Institute: December 2015) accessed 6 May 2019, <https://cei.org/sites/default/files/Wayne%20Crews%20-%20Mapping%20Washington%27s%20Lawlessness.pdf>.

8 Ibid.

A. Defining Regulatory Dark Matter

'Regulatory dark matter' has been defined by Clyde Wayne Crews of the Washington, D.C. based Competitive Enterprise Institute as "the thousands of executive branch and independent agency actions including guidance documents, proclamations, memoranda, bulletins, circulars, letters and more that are subject to little scrutiny or democratic accountability but carry practical, binding regulatory effects."⁹

In the Australian context it is common to make a threefold distinction between legislation, legislative instruments, and quasi-regulation.¹⁰ Legislation refers to acts of Parliament, and legislative instruments to those rules enacted by agencies with delegated authority from Parliament. Quasi-regulation represents further publications made by agencies that are not legally binding, but seek to influence the behaviour of regulated actors such as businesses.

In order to understand what constitutes regulatory dark matter in the Australian context this paper considers which of these levels of regulation fit our definition of "regulatory actions taken by departments and agencies that are subject to little scrutiny or democratic accountability".

1. Legislation

Legislation (primary legislation) falls outside of the definition of regulatory dark matter. Laws are made and passed by parliamentarians who are directly democratically accountable.

2. Legislative instruments

Classifying regulations made by agencies poses more difficulty. Departments and agencies possess delegated powers from Parliament to make legislative instruments. The rationale given for Parliament delegating power include arguments that it would save Parliament time, allow agencies to deal with technical details, and enable regulation to be more agile in response to changing circumstances.¹¹

9 Competitive Enterprise Institute, "What is Regulatory Dark Matter?" Accessed 8 April 19, <https://cei.org/content/regulatory-dark-matter>.

10 Australian Government, *The Australian Government Guide to Regulation* (Commonwealth of Australia: 2014), accessed 14 May 2019, https://www.pmc.gov.au/sites/default/files/publications/Australian_Government_Guide_to_Regulation.pdf.

11 J.R. Odgers, *Odgers' Australian Senate Practice 14th edition* (Commonwealth of Australia, 2016), 429-432.

Legislative instruments must be registered in the Federal Register of Legislation and can be disallowed by Parliament. The Senate Regulations and Ordinances Committee reviews the instruments and recommends the Senate to disallow instruments that do not meet their principles of scrutiny. The Committee's principles are concerned with legal and procedural matters which, according to some, has allowed them to maintain a non-partisan reputation. *Odgers's Australian Senate Practice* notes that the committee does not evaluate or debate the economic and regulatory merits of instruments:

The Senate has never rejected a committee recommendation that an offending instrument should be disallowed. Because its scrutiny is confined to its criteria, the committee avoids debates on the merits of policy. This, together with its endurance, ensures that it maintains a high reputation in supporting the Senate's legislative review function.¹²

This scrutiny, while important for legal and procedural considerations, falls short of democratic accountability for the economic ramifications of regulation. Indeed, the main consequence of regulatory dark matter is the effect it has on the economy, rather than purely technical procedural issues.

Some regulations will receive more scrutiny than others, making it difficult to classify individual regulations on a scale of democratic oversight. However, the fact that legislative instruments are created by delegated power and the limited resources devoted to scrutinising the regulatory effect of instruments means that it is appropriate to classify legislative instruments as part of regulatory dark matter.

There remains an important distinction between legislative instruments and quasi-regulation. For this reason, our sample of regulatory dark matter shows the contribution made from both legislative instruments and quasi-regulation and outlines the documents included for each agency.

3. Quasi-regulation

Quasi-regulation has been referred to by a number of names that try to capture its central characteristic. The terms 'quasi', 'soft law' and 'stealth law' emphasise its lack of official status as law, and the underhanded nature of its implementation. Quasi-regulation represents regulatory actions of the executive that are not officially binding law and are not overseen by a democratic body such as Parliament. These may include guidance materials, letters, and notes published by agencies.

¹² Ibid, 437.

In 2014 the federal government released *The Australian Government Guide to Regulation* which defined quasi-regulation as,

Any rule or requirement that is not established by a parliamentary process, but which can influence the behaviour of businesses, community organisations or individuals. Examples include industry codes of practice, guidance notes, industry–government agreements (co-regulation) and accreditation schemes.¹³

Agencies publish a wide range of materials that have a regulatory impact that is often overlooked. Guidance material, newsletters, and notes are often used by agencies to explain how the agency intends to interpret and enforce regulation. While guidance documents may perform a role in assisting businesses to comply with regulation, explanatory materials by nature contain varying degrees of interpretation that expand upon existing regulation.

Quasi-regulation, as defined above in ‘Guide to Regulation’ is not established by a parliamentary process and lacks direct democratic accountability. It is therefore included in our definition of regulatory dark matter.

¹³ Australian Government, *The Australian Government Guide to Regulation*

B. Measuring Regulatory Dark Matter in Australia

A sample of regulatory dark matter from five agencies in the banking and finance sectors shows the size of the problem in Australia. The agencies included in the count of regulatory dark matter are; the Australian Security Investment Commission (ASIC), the Australian Prudential Regulation Authority (APRA), the Australian Competition and Consumer Commission (ACCC), the Australian Accounting Standards Board (AASB), and the Auditing and Assurance Standards Board (AUASB).

The banking and financial sectors are of particular interest due to their rapid growth and the central role they play in the economy. Banking and finance are affected by a number of regulators and have come under scrutiny as part of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

The measure of regulatory dark matter is based on a page count of documents located on each agency's website. Guidance documents, reports, codes, and other information documents are included in the overall count along with legislative instruments in force from each agency. The types of documents counted for each agency are outlined below. This approach of counting regulatory dark matter is based on a similar approach by the Competitive Enterprise Institute (CEI) in the United States.

While the CEI presents dark matter over time, this report seeks to capture all current dark matter in effect. Legislative instruments currently on the federal register and quasi-regulation currently published on each agency's website are counted in total without a time series due to limitations with the availability of consistently reported information. Reporting the total amount of dark matter better reflects the size of the problem faced by regulated entities, as businesses must read, understand, and comply with all relevant available information from agencies.

Limitations

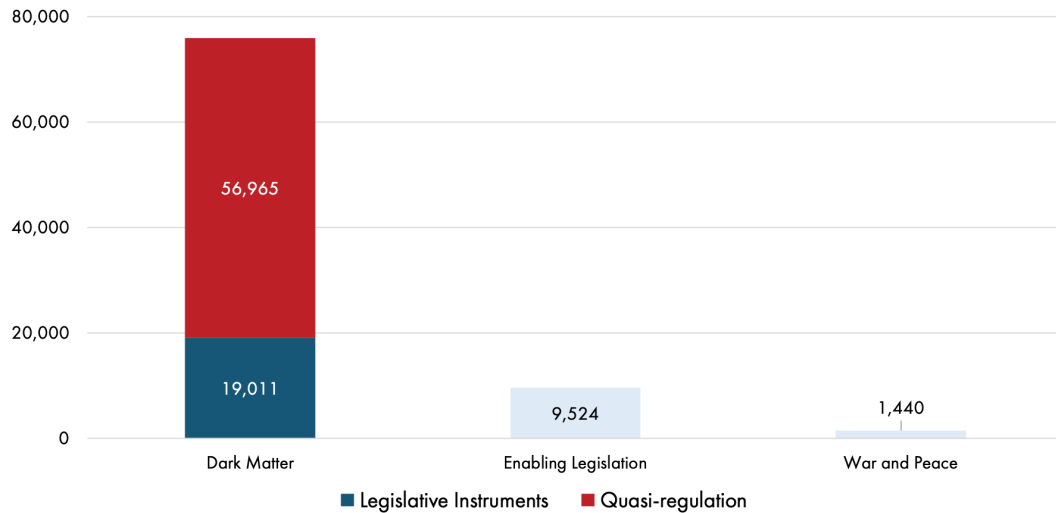
There are a number of limitations in the counting of regulatory dark matter for these agencies that may lead to both over and under counting in different areas.

Not all documents or parts of documents will be strictly regulatory in nature, this count may include pages that address non regulatory administration issues and information. These publications are counted even though they may have only a marginal effect on the red tape burden. Even when documents or parts of documents are not strictly regulatory, they do contribute to the information burden on regulated bodies seeking to comply with the regulator.

Substantial under counting will occur in measuring quasi-regulation due to the sheer number of publications made by agencies and the varying degrees of accessibility. This means that discretion must be used in selecting documents that should be counted. Differences in the presentation of information by each agency will unavoidably lead to a disparities in the count for each agency. The measurement presented takes a conservative approach and outlines the types of publications included from each agency.

Regulatory Dark Matter

Figure 1: Pages of Regulation



The total number of pages of regulatory dark matter counted for the five agencies was 75,976. Of this total, 19,011 pages were from legislative instruments, and 56,965 pages were from quasi-regulation documents.¹⁴ To put these numbers in perspective, the total count of regulatory dark matter for just five agencies is 8 times larger than the enabling legislation for the included agencies, and more than 52 times larger Leo Tolstoy's *War and Peace*.¹⁵

The numbers and types of materials counted for are listed for each agency:

Australian Security Investment Commission (11,018 pages)

Legislative instruments and accompanying explanatory documents totalled 2,756 pages. Quasi-regulation documents included regulatory guides and information sheets adding 8,262 pages.

Australian Prudential Regulation Authority (13,110 pages)

Standards, explanations and extras totalled 10,642 pages. A further 2,468 pages of quasi-regulation was counted from guidelines, letters, and information papers.

¹⁴ Calculated based on documents from each agency's website and legislation.gov.au.

¹⁵ Leo Tolstoy, *War and Peace* (Penguin Books, 2009).

Australian Competition and Consumer Commission (44,160 pages)

Publications, excluding those aimed at consumers, totalled 44,160 pages. These publications include codes, guide lines, and reports.

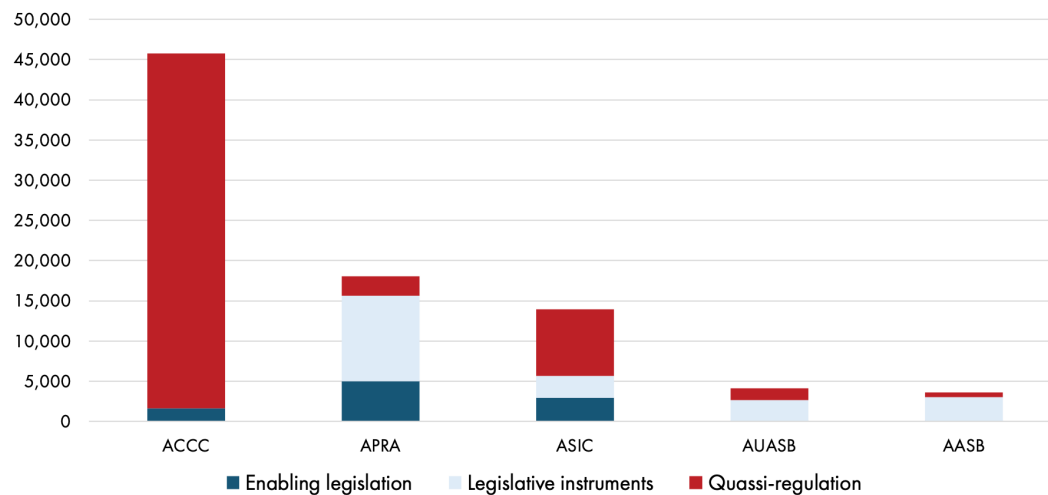
Australian Accounting Standards Board (3,563 pages)

There were 2,996 pages of accounting standards, with a further 567 pages of interpretations.

Auditing and Assurance Standards Board (4,125 pages)

Auditing standards total 2,617 pages. Guidance, explanatory guides, and other publications bring the quasi-regulation count to 1,508 pages.

Figure 2: Pages of Regulation by Agency and Type



Understanding the Problem of Regulatory Dark Matter

1. Guidance material

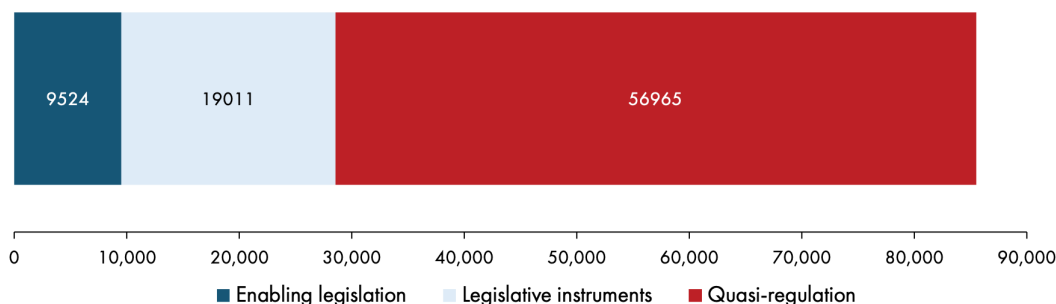
In many cases guidance materials provide businesses with information that assist them with complying with regulation. For this reason it can be argued that there is an optimal amount of guidance material so that businesses and industry have a clear understanding of how the regulator intends to enforce regulation. However, there are several issues created by guidance material.

Some businesses may prefer direct statements by the regulator to provide certainty that their business actions comply with the law, however guidance material does not provide this certainty. Businesses can run afoul of the regulator even if they have followed guidance material. Ultimately the businesses will be held to the wording and interpretation of the official regulations.

Excessive amounts of guidance material increases the regulatory burden on business. While guidance materials are not officially binding, the risk of ignoring signals from regulators can be substantial. Red tape in this form can also disadvantage small businesses who lack the resources to access legal expertise for compliance. Attempts to understand the meaning of laws, and wading through guidance material can be costly for businesses and other organisations.

Striking a balance between providing necessary information and not adding to red tape requires a broader approach to red tape reduction. Each level of regulation builds upon the supporting level. This can be seen clearly in the page counts of the five regulators in this report as shown in Figure 3. The enabling legislation passed by Parliament that grants powers to these agencies totals 9,524 pages, with each level building on top. The greater the amount of red tape in legislation, and legislative instruments, the greater the need for the proliferation of guidance material.

Figure 3: Structure of Regulation (Number of Pages)



The need for guidance is also exacerbated by the use of legalese that is inaccessible to businesses, particularly smaller businesses that lack the ability to devote sufficient resources toward legal expertise.

The D.C. Circuit in the USA articulated the problem of the propagation of regulation that builds on foundational levels in a way that is applicable to Australia's red tape problem:

Congress passes a broadly worded statute. The agency follows with regulations containing broad language, open-ended phrases, ambiguous standards, and the like. Then as years pass, the agency issues circulars or guidance or memoranda, explaining, interpreting, defining, and often expanding the commands in regulations. One guidance document may yield another and then another and so on.¹⁶

2. Lack of Democratic Accountability and Transparency

The definition used of regulatory dark matter highlights the lack of democratic accountability of rule makers. As highlighted above, legislative instruments are implemented by a delegated power from Parliament that in practice lacks a high degree of democratic oversight. Although the Senate has a process by which they can disallow legislative instruments, in practice the scrutiny is highly delegated and does not adequately evaluate the economic impact of regulation. Quasi-regulation is further removed from the democratic process of accountability. Agencies are able to use various publications for regulatory purposes without going through the processes and checks involved in passing legislation or regulation.

When rules can be made and implemented by unelected bureaucrats there are perverse incentives for regulatory expansion. The institutional structure allows bureaucrats to expand the power and influence of their agency without direct democratic accountability.

¹⁶ Crews, *Mapping Washington's Lawlessness*.

The issue of the accountability of agencies raises foundational questions about the role of government. It may be the case that direct accountability is impractical given the current size of the administrative state. Government regulatory intervention into all areas of the Australian economy requires a large bureaucratic state that must rely heavily on delegation to operate.

Regulation in the banking sector, for example, is complicated by the role that government takes in monetary policy, the insuring of bank deposits, and the implied commitment to bail out banks should they fail. This heavy government involvement depends on agencies to actively manage risks in the sector and respond to changes in the financial environment. Parliament delegates power to government organisations such as the RBA, ASIC, and APRA to effectively carry out this role. This is a problem that extends to all areas of the economy. Government intervention into the economy with licencing, subsidies, wage controls, employment contract requirements, and standards creates work for agencies to carry out.

The problem with the amount of regulatory dark matter and the lack of accountability for this form of rule-making is in many ways a symptom of a government that has taken a heavy handed approach to regulation.

Proposals

The following proposals are given as ways to alleviate the contribution of regulatory dark matter to the red tape burden.

1. Cut red tape in legislation by introducing a one-in-two out approach

Regulatory dark matter in the form of legislative instruments and quasi-regulation are built upon enabling legislation passed by Parliament. This legislation too often takes a heavy handed approach to regulation assuming an interventionist role for the government in the economy. Decreasing the red tape burden requires a rethinking of government intervention that begins with legislation.

The Commonwealth Government should take a one-in-two out approach to regulation. This approach was taken by the Trump administration, with one of President Trump's first executive orders requiring "that for every one new regulation issued, at least two prior regulations be identified for elimination."¹⁷ IPA research estimated that if the Coalition government had implemented such a policy when it came to office in September 2013, there would have been 107,885 fewer pages of primary and secondary regulation by May 2017.¹⁸

2. Improve the quality of regulation.

The need for further levels of regulation is due to the lack of clarity and precision in preceding levels of regulation. Broadly worded and vague legislation and legislative instruments call for detail and guidance. Clear and direct legislation removes the discretionary power of agencies. Parliament should take a greater degree of responsibility for regulation rather than delegating to agencies and watering down democratic accountability of rule makers and enforcers in the process.

3. Hold regulators accountable for their contribution to the red tape burden

Regulators should not be free from scrutiny on their role in expanding the red tape burden on businesses and organisations. Governments need to prioritise red tape reduction and hold agencies accountable when they add to the red tape burden. Agencies should be directed to clean up their websites to clearly present necessary information. The problems surrounding guidance material and quasi-regulation documents needs to be acknowledged and included in any government's deregulation agenda.

¹⁷ White House, "Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs," accessed 14 May 2019, <https://www.whitehouse.gov/presidential-actions/presidential-executive-order-reducing-regulation-controlling-regulatory-costs/>.

¹⁸ Daniel Wild, *Reducing Red Tape in Australia: 'One In, Two Out' Rule* (Institute of Public Affairs) accessed 6 May 2019, https://ipa.org.au/wp-content/uploads/2017/05/IPA_Report_Reducing_Red_Tape_In_Australia_One_In_Two_Out_Rule_170504.pdf.

Conclusion

Tackling the red tape problem requires understanding the way that red tape is implemented and the various ways that it negatively impacts the economy. There are strengths and weaknesses to various methods of measuring red tape that highlight different aspects of the regulatory burden on the economy. Measuring the size of the problem allows us to hold governments to account and to track the progress being made by government deregulation initiatives.

Analysing regulatory dark matter directs attention toward the agencies that are often the face of red tape to businesses and organisations. Although the regulatory effects of these agencies can be difficult to quantify given the nature of regulatory dark matter, it is critical that governments hold agencies accountable who are operating on delegated power from Parliament.

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About the author

Kurt Wallace is a Research Fellow, working in the IPA's Dignity of Work program.

Kurt joined the Institute of Public Affairs as a Research Fellow in 2018.

He is interested in individual liberty, the expansion of free markets, the importance of ideas and culture, and studying the ill effects of government intervention in the economy. His work at the IPA focuses on industrial relations, the dignity of work, and red tape.

Kurt received a Bachelor of Commerce (Honours) from Monash University, majoring in Economics and Finance.

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