COUNTING THE COST OF RED TAPE

for business in South Africa

Headline report

November 2004

SBP

Strategic partnerships for business growth in Africa

This headline report was prepared by a team led by Chris Darroll, and comprising Graham Bannock, Lawrence Schlemmer, Luqman Ahmad, Simon Dagut, Kerri Hampton, and Douglas Irvine. The survey was conceptualised by SBP, which commissioned MarkData (Pty) Ltd to devise the sampling and carry out the field work and computer analysis. SBP and MarkData gratefully acknowledge the co-operation of the business executives and owners who participated in the survey.

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Foreword

Regulatory compliance – red tape – cost South African businesses R79 billion in 2004, an amount equivalent to 6,5 per cent of GDP.

This is the bottom-line result of SBP's pioneering study of regulatory compliance costs to the South African private sector, from large corporations through small and medium enterprises (SMEs) to the informal sector. No comprehensive survey of this kind has previously been undertaken in this country. Indeed, to the best of our knowledge, it is the largest general regulatory cost survey ever carried out anywhere.

Organised business and the South African government agree that it is necessary to create an enabling environment which spurs economic growth and job creation. Our study provides strong research-based evidence with which to take forward the discussion about how to achieve a regulatory environment that will be most conducive to the private sector's optimal performance, particularly for SMEs. The study is also a valuable point of reference in the growing debate around the institutionalisation and use of regulatory impact analysis in South Africa.

The rewards of an improved regulatory environment are large. A 2002 study of 10 developing countries including South Africa by SBP and Bannock Consulting concluded that an appropriate regulatory environment was the single most important element in an economic growth strategy. A 2004 World Bank study has found that many developing countries could improve their annual growth rates by as much as 1,4 percent if they created a world-class regulatory environment for business. Though South Africa has a better regulatory system than many developing countries, improving the regulatory environment could have a significant impact on our economic prospects too.

Improving the regulatory environment will take hard work, and excellent information. However, unlike improvements in education or health, results can be seen relatively quickly. What's more, the socio-political costs of much regulatory reform are low: nobody was ever elected to parliament on a promise to increase red tape. Well-informed, well-designed regulatory reform presents an opportunity to accelerate growth and development that South Africa cannot afford to miss.

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Chris Darroll
Executive director, SBP
Johannesburg, November 2004

Highlights

- This is the largest survey of its kind ever undertaken anywhere in the world.
- Thirty-four per cent of businesses surveyed cited the interface between the state and business as their biggest constraint to expansion and employing more staff.
- The most troublesome and time-consuming regulations were VAT (19 per cent of responses), other aspects of tax administration, labour laws, and SETA/RSC levies, in that order.
- Seventy-six per cent of respondents said that compliance costs had increased over the past two years; 80 per cent noted an increase over the past ten years; and 83 per cent expected these costs to increase further in the future.
- On average, the annual costs of regulatory compliance were R105 000 per firm.
- Big firms have the largest costs absolutely but, in relation to their size, small firms bear the heaviest burden. Compliance costs represent 8,3 per cent of turnover for enterprises with annual sales of less than R1 million, and 0,2 per cent of turnover for corporations with sales of R1 billion or more.
- Informal enterprises are deterred from entering the formal economy because of the higher tax burden, and the red tape they would have to face.
- In 2004, South African businesses incurred regulatory compliance costs of about R79 billion, or 6,5 per cent of GDP. This is a significantly higher percentage of GDP than in many developed countries.
- New research by the World Bank has shown that an improved regulatory environment could increase economic growth in many developing countries by as much as 1,4 per cent a year.

SBP's recommendations

- The creation of a Regulatory Impact Analysis capacity in government to advise on the costs and benefits of proposed new regulations.
- A systematic review of the costs and benefits of the existing regulatory environment.

Introduction

This report is based on a ground-breaking survey of the costs of regulation to the South African private sector. Between February and June 2004, a total of 1 794 businesses throughout the country were interviewed in depth, making this the largest survey of its kind undertaken anywhere in the world. Respondents ranged from corporations on the top 200 list to enterprises in the informal sector. The survey covered all the sectors of the economy, including manufacturing, mining, construction, trade, agri-business, and services.

Regulations are vital to the fair and sustainable working of market economies, but even the most socially necessary regulations create costs as well as benefits, and some of these costs may be unnecessarily high. It is very important to distinguish between a regulation and the costs created by complying with it. For instance, health and safety regulations are unarguably essential. This does not mean, however, that we should accept the current level of associated regulatory costs as fixed. It may well be possible to reduce the costs of complying with regulations without reducing their benefits. Reducing regulatory costs can be very beneficial: studies by the World Bank covering 145 countries have demonstrated that countries with higher regulatory costs have larger informal sectors, more unemployment, and slower growth.[1]

SBP's survey looked in detail at two kinds of regulatory costs faced by the private sector: efficiency costs, and compliance costs.[2]

Efficiency costs arise because regulation may distort market outcomes. If employment is discouraged by inappropriate labour market regulation, for example, then the costs of the resulting unemployment in terms of lost output and incomes is an efficiency cost. Other examples of the efficiency costs of regulation would be a business's decision to restrict output to keep sales below the VAT threshold, or an inability to compete in an export market because the costs of complying with regulations have made a product too expensive. The efficiency costs of regulation are usually by-products of contested political processes. Often, difficult political choices have to be made if they are to be reduced.

Compliance costs are pure red tape costs: that is, they are the incremental costs incurred by business in the course of complying with regulations. They include the value of time spent by business managers and staff on understanding the rules and applying them; interacting with the authorities to clarify matters arising; and the payments made for the expertise of professional advisers, such as consultants, lawyers, and accountants. For instance, the costs of tax paperwork are compliance costs, while the tax payments themselves are not. Capital costs of compliance, such as those for effluent or smokestack equipment, were excluded from our study.

For informal sector enterprises only, questions were also asked about the costs arising from harassment by police and others, and of bribes. These we term the costs of non-compliance.

In contrast to efficiency costs, compliance costs are usually not the result of conscious political choices. No one is elected to parliament on a promise to increase the number of forms that have to be filled in. This means that reducing some of the compliance costs of regulation can be a relatively quick, easy, and uncontroversial process.

This study provides a great deal of significant information about the ways in which South African businesses experience the efficiency costs of regulation. These are important results, but they are not unique. Though this study is distinguished by its scale, depth, representivity, and specific focus on regulations, there have been several other surveys which have covered similar ground in asking questions about how business owners and managers perceive the investment climate and the regulatory environment.

What makes SBP's regulatory cost study uniquely valuable is that it provides hard data on compliance costs. For the first time in South Africa, we have quantitative information about how much red tape actually costs businesses. We now also have a much clearer picture of the precise incidence of regulatory compliance costs.

It might be thought that business people would be tempted to exaggerate the costs of regulation. This is certainly possible, partly because smaller and more vulnerable businesses might overstate the extent to which they actually comply with regulations in an interview. Some large businesses with many subsidiaries might, in the absence of detailed information at headquarters, also overstate their regulatory costs. Equally, however, the bias could go the other way. For example, our researchers found that respondents overlooked whole areas of minor (but cumulatively significant) regulatory costs because each small cost appeared trivial in comparison with more conspicuous regulatory requirements. Moreover, any bias in estimation will have been more than compensated for by our adoption of conservative assumptions in grossing up from the sample to business as a whole, and by our exclusion of the capital costs associated with regulatory compliance. We consider, therefore, that our results are under- rather than overstated.

It is important to note that we have not attempted to measure the benefits of regulation. Our estimates of compliance costs are gross of the benefits accruing to individual firms or to society in general. Clearly, the benefits of regulation are often substantial, but these are usually far better understood than their costs. It is therefore appropriate to focus research effort, at least in the first instance, on regulatory costs.

Our survey and accompanying desk research has produced a mass of data. In this headline report, we present only the highlights of our analysis of the survey results. A full report, including sector studies, will be released in 2005.

We begin with an outline of the constraints on growth and the costs of regulation, as perceived by our respondents. This is followed by an overview of the efficiency costs of regulation, as identified by our respondents. Next, we briefly outline the regulatory framework in South Africa, presenting results on which regulations are perceived by businesses to be most troublesome to comply with, and report perceptions concerning the growing complexity of the regulatory environment. We then move to the core of our report: the principal findings on regulatory compliance costs. We also consider the costs of compliance and non-compliance for the informal sector. Our overall conclusions, which include a discussion of possible comparisons between South Africa's regulatory compliance costs and those in other countries, are presented in the final section.

Business perceptions of constraints on growth and regulatory costs

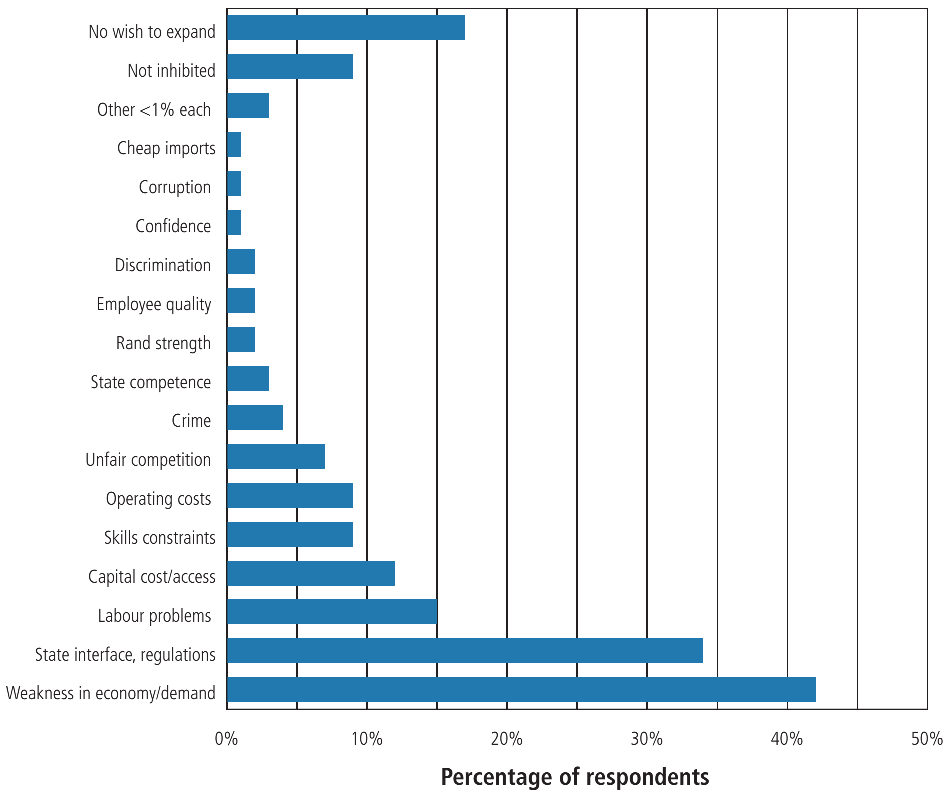
At the outset, our survey sought to elicit open-ended responses about the business environment. The objective was to let respondents put regulatory issues in a broader context before asking detailed questions about regulatory costs. Respondents were aware that regulatory issues were the main focus of the survey, but by probing for second and third responses the interviewers neutralised any possible overemphasis of regulations. The answers were unprompted, and respondents were expected to state which three issues were uppermost in their minds.

The first question was: What factors of any kind prevent or discourage a business like yours from expanding its operations? The results are presented in figure 1.

A wide range of factors is perceived to limit growth. Of the constraints mentioned, two stand out: weakness in the economy, or a lack of demand; and a range of factors resulting from the state's interface with business. These two factors are ahead by some way of the third and fourth: labour problems, and affordable access to capital.

Figure 2 breaks down the growth-inhibiting factors that arise at the state interface. It can be seen that respondents perceive these as entailing efficiency costs, except for the single largest category, which is the pure red tape of regulatory compliance. Regulatory compliance costs are followed by black economic empowerment (BEE) issues (which have yet to make their full effect felt). Labour and taxation issues are also significant.

Figure 1: Factors inhibiting business growth



Note: Percentage exceeds 100 because many respondents gave more than one response. The results in figures 1 to 7 are based on the main integrated sample. See technical appendix for details.

Figure 2: State interface – constraints on growth

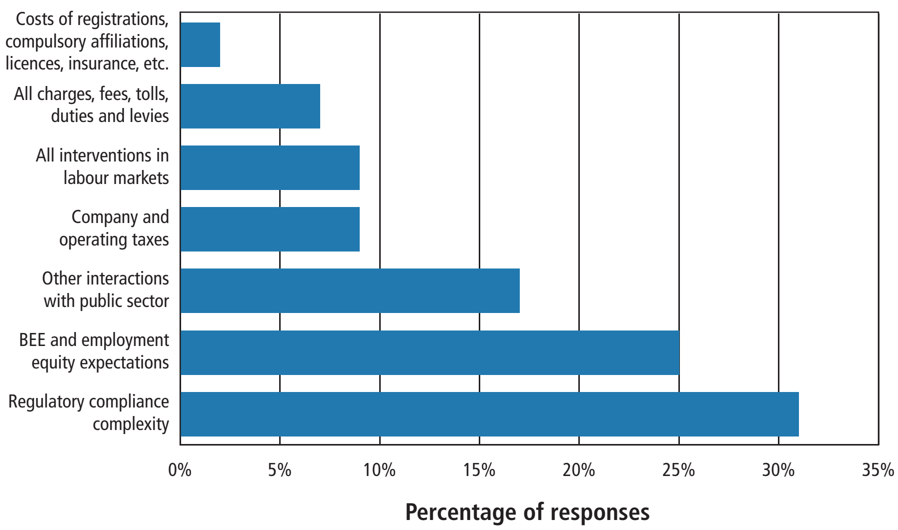


Figure 3: Constraints on increased employment

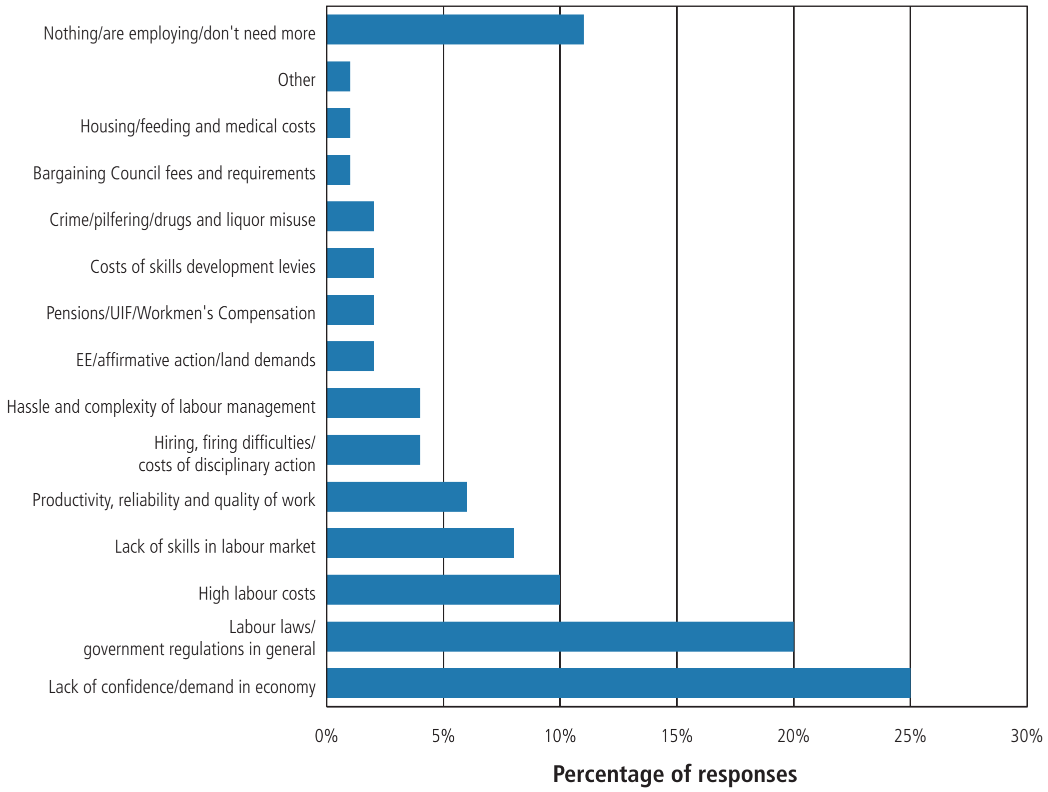
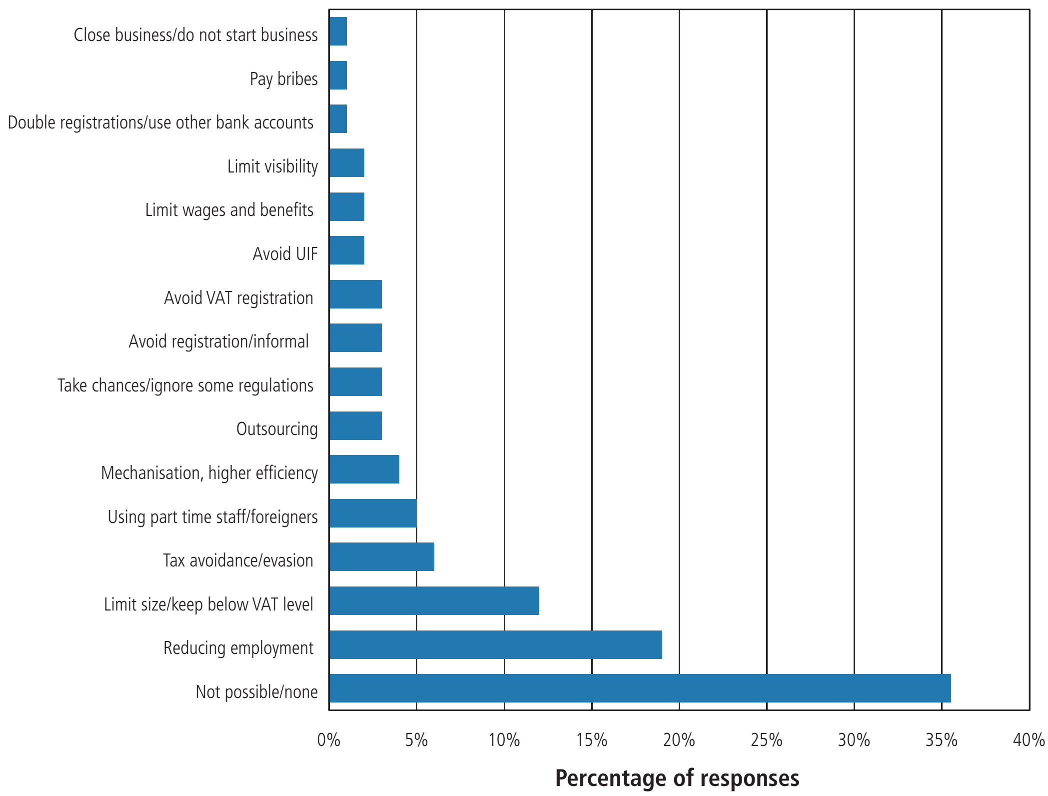


Figure 4: Ways of avoiding regulatory compliance



A detailed analysis of the responses by sector shows that, relatively speaking, the impact of state-induced constraints is greatest in transport, services, and tourism (the last-named arguably the single most important growth sector), and least in retailing and wholesaling. Manufacturing, also a key growth sector, emerges as slightly above average in terms of constraints originating at the state interface. These constraints are, in the perception of respondents, greatest for the largest enterprises, and least significant for micro enterprises.

Figure 3 summarises the pattern of responses on constraints on increased employment. Again, a lack of confidence or demand in the economy attracted the most mentions, followed by labour laws, and government regulations in general. Some of the other factors, such as hiring and firing difficulties, employment equity, and various employment-related costs are heavily influenced by government actions. The responses generally give the impression that regulatory costs – of both the efficiency and compliance varieties – are an important reason why South African businesses are reluctant to hire more staff.

Further evidence about the efficiency costs of regulation comes from responses to one of the last questions in the survey: Thinking of other businesses like yours in general, what things are done to avoid the costs of regulation?[3] The responses are summarised in figure 4. A large minority of 35 per cent did not think it possible to avoid regulation. The majority did think it possible, and believed that reducing employment or curtailing business growth would be the most common way to avoid complying with regulations. Both are very significant efficiency costs.

To summarise the findings of this section: respondents reported that the regulatory environment imposed significant efficiency costs on their businesses, reducing their propensity to expand their operations and to create jobs. Most importantly, however, the single largest growth-inhibiting aspect of the state interface was the pure red tape of regulatory compliance costs.

The regulatory framework

Before we move on to the detailed findings on regulatory compliance costs, we briefly review the overall framework which gives rise to these costs. The full scope of the regulatory system is probably not familiar to most readers. In fact, it is unlikely that anyone actually knows how many regulations there are, or how they have changed over time. There is no comprehensive database of regulations in South Africa. Although regulatory powers and responsibilities are conferred by legislation, the detailed interpretation of these powers into specific rules and requirements takes the form of ministerial orders, departmental guidance notes, and other instruments issued by central, provincial, and local governments and their agencies. These are nowhere brought together.

Right from the beginning, a new enterprise with a turnover of more than the VAT threshold (R300 000) will have to comply with nine separate registration requirements, involving contact with five different central government offices. Thereafter, the business will face a large number of other requirements, examples of which are given in box 1. These cross-cutting measures affect businesses of every kind. In addition, almost every sector of the economy has regulations specific to its type of operations. Examples include labelling requirements for foods and pharmaceuticals, construction and use regulations affecting motor vehicles, and prudential regulations for banks and other financial institutions. Businesses may also be required to comply with provincial and municipal regulations affecting, for example, zoning, signage, licensing, and local rates and taxes.

Businesses have to spend time learning what regulations apply to them, complying with them, and keeping up to date with changes. Larger firms in particular need to comment on proposed and current legislation and regulations, as part of the process of consultation with

Box 1: Cross-cutting regulatory requirements

These are the most important regulations that affect most formal businesses. However, this is not a complete list of all general regulations. In addition, almost every sector of the economy has regulations that are specific to its type of operations.

General start-up: nine registration requirements, five different offices

Reserve a company name
Register name and articles of association
Register for: VAT; skills levy, indicating the relevant SETA; PAYE; Income tax
Register with Unemployment Insurance Fund; Regional Services Council
Register as employer for Workman's Compensation

People and workplace

Industrial Relations Act
Basic Conditions of Employment Act
Occupational Health & Safety
Compensation for Occupational Injuries and Diseases Act
HIV/AIDS and Employer
Skills Development Act & Levy
Unemployment Insurance Act
Employment Equity Act
Broad Based Black Economic Empowerment Act

Taxation

Standard Income Tax on Employees (SITE)
Income tax
Secondary tax on companies
PAYE
Provisional tax
Capital gains tax
Value added tax
Regional services council levy

Miscellaneous

License fees
Stamp Duties Act
Price controls
Competition Act
Consumer Affairs Act
Promotion of Access to Information Act
Trade marks, registered design, patents, merchandise marks, copyright
Environmental policy & legislation
National Environmental Management Act

- Environment Conservation Act
- Atmospheric Pollution Prevention Act
- National Water Act

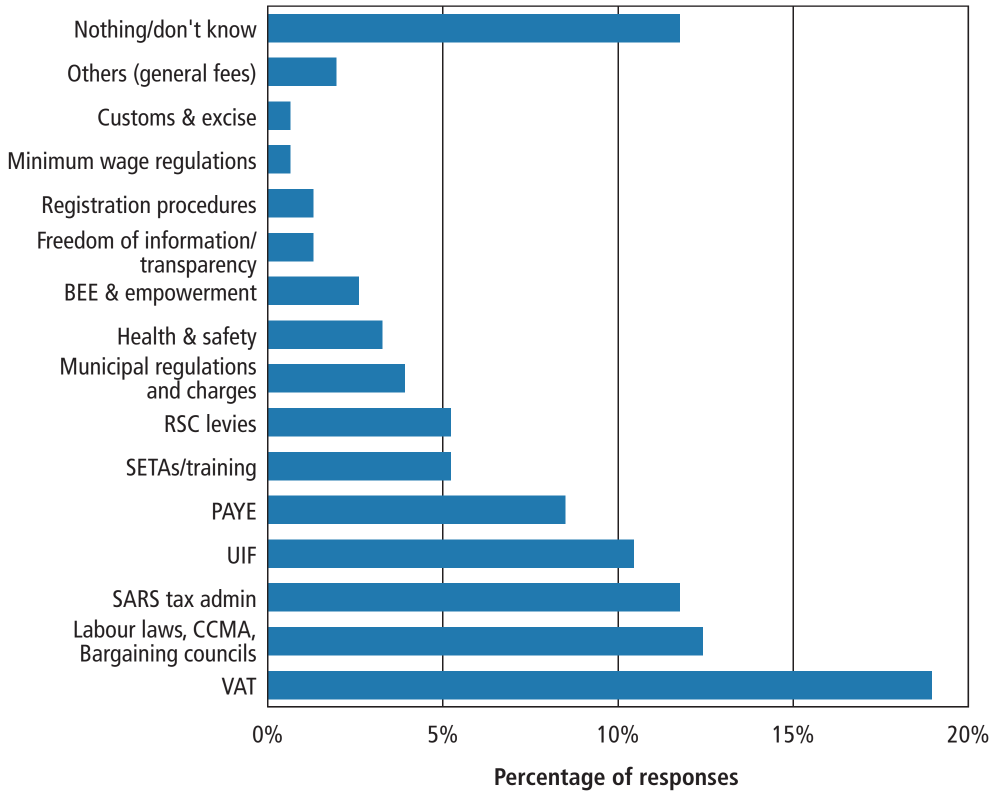
Tourism levies and requirements
Customs & excise

government. Many businesses are also obliged to spend time collecting information, often highly detailed, to respond to compulsory questionnaires from Statistics South Africa.

Respondents were asked to name the three regulations found to be most time-consuming, costly, and troublesome. Figure 5 gives the rank order as a percentage of all responses.

VAT was cited in 19 per cent of responses, and this, with other tax-related issues (PAYE and SARS together totalling 20 per cent) emerged as the most problematic regulations. Labour laws were mentioned in 12 per cent of the responses, and SETA and RSC levies in 11 per cent. No other issue attracted a mention in more than 5 per cent of the responses.

Figure 5: Most time-consuming and troublesome regulations



It is interesting that socially important issues, such as health and safety (3 per cent) and empowerment (2,5 per cent), were not prominent, and environmental issues did not figure at all.

Respondents were asked whether the real costs (ie allowing for inflation) of complying with official regulations had decreased, increased, or remained constant. Overall, 76 per cent of respondents thought regulatory costs had increased over the past two years, and 80 per cent thought they had increased over the past ten years. Asked about the future, no less than 83 per cent expected costs to increase. These views were remarkably similar between sectors: only in agriculture did less than 74 per cent of respondents perceive an increase over the past two years. For the past ten years, again excepting agriculture, 80 per cent or more of respondents in all sectors perceived an increase. The pattern of responses was somewhat more variable by firm size band, with 64 per cent of the smallest firms and 95 per cent of the largest firms indicating an increase over the past two years.

The compliance costs of regulation

Respondents were asked to estimate the value of time spent and outsourced costs incurred in complying with regulation over a year. These questions were asked for each of the eight categories of regulation as listed in table 1.

Table 1: Average estimated annual administrative, manpower, supervisory, and professional costs of regulatory compliance: means for the range of applicable state regulations

Type of regulation	Mean costs
Company registration (initial)	R 9 371
Professional fees	R 6 107
TOTAL	R 15 478
Company registration (annual)	R 6 262
Professional fees	R 3 388
TOTAL	R 9 650
Tax compliance	R 15 709
Professional fees	R 11 589
TOTAL	R 27 298
Labour and employment	R 11 735
Professional fees	R 6 557
TOTAL	R 18 292
Employment equity/empowerment	R 5 525
Professional fees	R 6 835
TOTAL	R 12 360
Additional regulations	R 18 866
Professional fees	R 3 241
TOTAL	R 22 107
Government information	R 6 389
Professional fees	R 2 283
TOTAL	R 8 672
Local government regulations	R 5 542
Professional fees	R 1 253
TOTAL	R 6 795
Overall mean costs of compliance per firm	R 120 652
Mean recurring costs (Initial registration excluded)	R 105 174

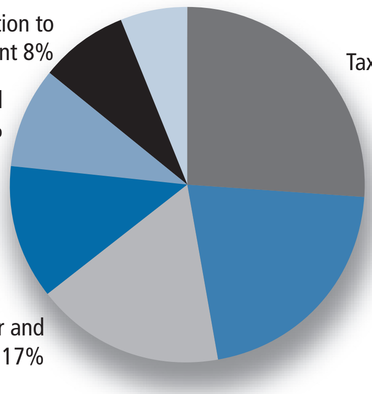
Note: Some respondents were unable to break down costs between all the categories. These costs, amounting to 4.6 per cent of the total, were allocated to categories in line with the average for other respondents.

Table 1 shows the mean (average) costs for all respondents – a cross section comprising 1140 firms — in eight categories of regulation. Average total recurring compliance costs per firm, excluding initial registration, were R 105 174 for all sizes and sectors.

Figure 6 shows that the largest element in this total of R 105 174 is tax compliance, followed by additional (ie other) regulations, including elements specific to certain kinds of business. These two categories are followed by labour-related compliance costs and by initial registration requirements (ie, a non-recurring cost), with annual registration costs being considerably lower. Employment equity/empowerment is fifth, followed by government information (for example, responding to statistical inquiries), and last, local government requirements.

Looked at sector by sector, the data show that the tourism, manufacturing, mining, power and water sectors bear the heaviest mean burden of compliance costs, followed fairly

Figure 6: Breakdown of recurring compliance costs



closely by transport. It should be noted that these variations are affected by the different average size of operations. Taking average firm size per sector into account, tourism and manufacturing; mining, power, and water; and the service sector are still relatively heavily regulated. It is difficult to generalise about differences in the percentage breakdowns of average costs, but additional regulations (largely sector-specific) contribute above average proportions to the total in manufacturing, mining, power and water, and especially in tourism. Labour and empowerment issues, taken together, assume relatively large proportions in transport, manufacturing, mining, power, and finance. Local government requirements are a small proportion of the total in all sectors. They are, however, relatively high in trade and services.

The relative importance of different types of regulation to total compliance costs varies with firm size. Table 2, which includes recurring costs only, gives total costs and their breakdown by regulatory category for each enterprise size band. Tax compliance costs are much larger proportions of the total for the smallest firms: 34,7 per cent for those with compliance costs of less than R1 million, compared with 11,5 per cent for those with compliance costs of more than R 1 billion. By contrast, labour regulations are somewhat less important for smaller firms: 14,7 per cent of the total, compared with 19,5 per cent for larger firms.

The incidence of compliance costs is sensitive to firm size in another very important way: while big firms have the largest costs absolutely, in relation to their size small firms bear the heaviest burden. For example, the 20 firms in our sample with a turnover of more than R 1 billion incurred costs of R 23 million each on average. However when set against the massive scale of their operations, a different picture emerges.

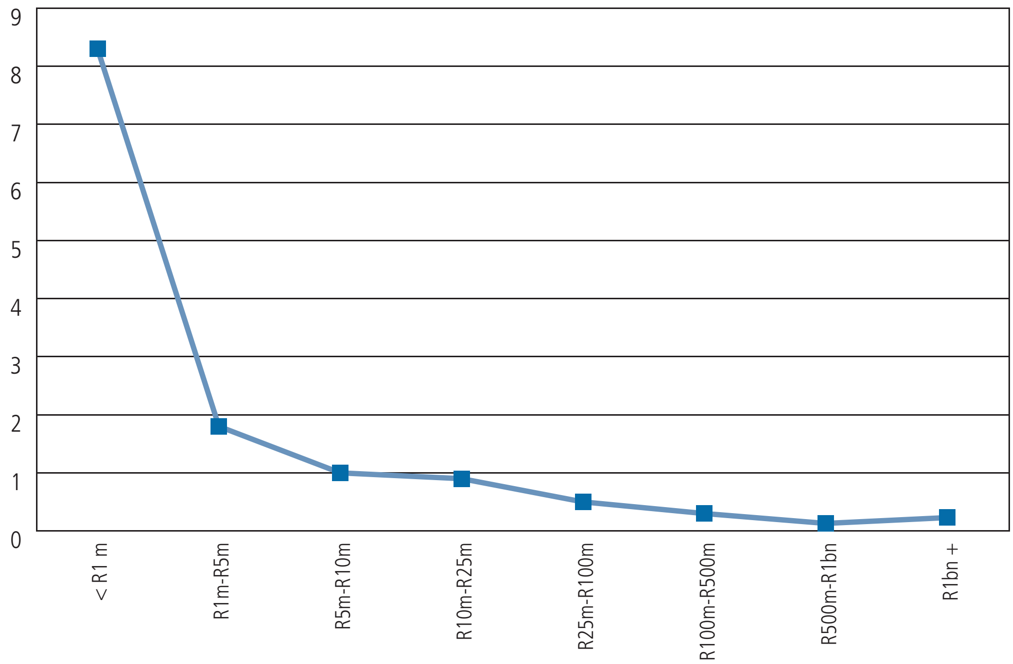
Figure 7 shows compliance costs as a percentage of turnover for each turnover size band. The ratio of compliance costs to turnover drops fairly smoothly as firm size increases, from

Table 2: Recurring regulatory compliance costs by type of regulation and enterprise turnover band

Type of regulations: Percentage distributions of recurring costs	<R1m	R1m–<R5m	R5m–<R10m	R10–<R25m	R25m–<R100m	R100m–<R500m	R500m–<R1bn	>R1bn
Ongoing registration	16,1%	11,9%	7,9%	12,1%	5,5%	9,8%	1,2%	6,7%
Tax compliance	34,7%	45,6%	34,9%	32,8%	31,6%	12,1%	22,8%	11,5%
Labour/personnel	14,7%	9,1%	15,2%	23,7%	14,1%	‘24,3%	16,2%	19,5%
Employment equity/ empowerment	7,1%	7,4%	12,6%	10,3%	22,1%	14,9%	9,7%	14,6%
Additional regulations	6,1%	6,5%	9,1%	5,8%	11,0%	22,4%	10,8%	38,2%
Statistical returns	9,2%	9,7%	8,5%	11,4%	9,5%	12,2%	17,2%	6,6%
Local government requirements	12,0%	9,8%	11,8%	3,9%	6,3%	4,3%	22,2%	2,9%
Recurring costs	R 32 482	R 54 766	R 66 311	R 159 913	R 286 109	R 675 286	R 891 854	R 2 314 727

8,3 per cent for the smallest size band to 0,2 per cent in the largest. This pattern reflects the fact that there are economies of scale in regulatory compliance. Certain basic costs, such as those for licensing or registration, are fixed and borne by all firms, but are spread over more turnover for the bigger firms. In addition, large firms are better placed to absorb these costs, given their higher turnover. Large firms manage compliance costs by employing in-house specialists.

Figure 7: Annual regulatory compliance costs as a percentage of turnover



Regulatory costs clearly impact disproportionately on small firms. Average compliance costs per person employed for firms with fewer than five employees are ten times higher than for a firm with 200 to 499 employees.

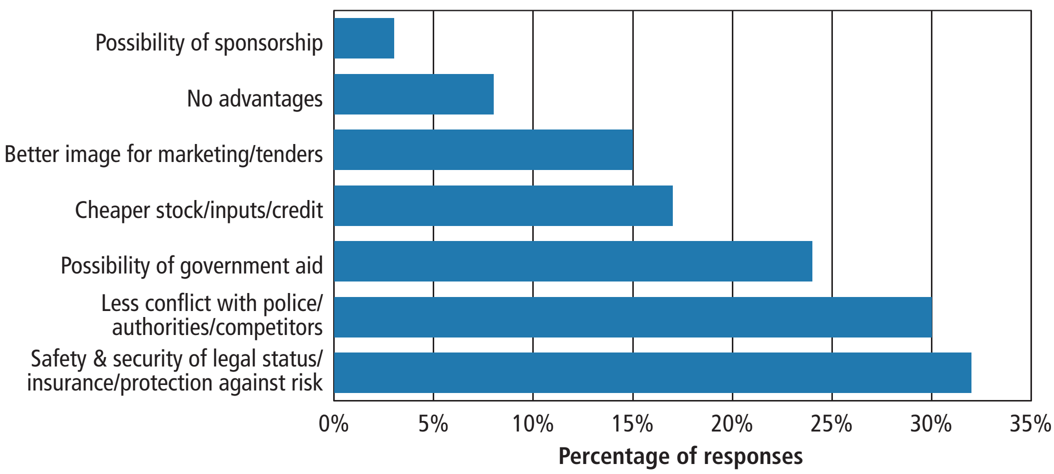
The informal economy

The results considered so far have not included the informal sector in South Africa. This sector employs about 2 million people, so it is essential to rectify this omission as far as possible despite the obvious difficulties in gathering comprehensive and reliable data on the informal economy.

The conventional wisdom that the informal sector is dominated by survivalists is questionable. Although most informal businesses are indeed tiny, the sector is very diverse, and includes some fairly substantial operations. Furthermore, 57 per cent of the informal sector operators in our sample said that they would prefer to run their own business rather than take a job. This sector is a reservoir of entrepreneurial energy and experience that could be harnessed for the further development of the economy and the alleviation of poverty.

By definition, the informal sector is excluded from most of the regulatory system. But this does not mean that it is unaffected by it. First, informal enterprises are often subject to harassment, and some are forced to pay bribes to be able to stay in business. These are the costs of non-compliance as distinct from the compliance costs borne in the formal sector. Second, formal status is necessary for fuller access to credit, supplies, markets, secure premises and so on. The high compliance costs and tax regime in the formal sector act as an insurmountable barrier for most informals seeking to grow. Our special survey of informal businesses provides evidence on both these points, and reveals some surprising facts about the sector.

Figure 8: Advantages of registration



Many of the 150 informal enterprises in our countrywide sample were young, and still vulnerable to failure. The median average age of the enterprises was about 3,5 years.[4]

About half the informal businesses consisted of the entrepreneur on his or her own, the rest having between one and five employees. About three quarters of the firms were in retail and personal services (catering, fruit stalls, hairdressing) while a quarter were in repairs, small manufacturing, transport, and other activities.

The firms were mostly very small, with a median sales turnover of only R8 482, although 8 per cent had annual sales of R50 000 or more, and 3 per cent sales of R100 000 or more.

Firms outside retailing and personal services had twice the sales, and a larger proportion said their business was expanding.

Some firms did have permits and licenses to operate at a particular place, and for these the average costs were R225 a year (2,6 per cent of their sales turnover in terms of medians). Respondents were asked whether or not officials had interfered with their operations in any way, and some 28 per cent indicated that this had occurred. Among that 28 per cent, 62 per cent had had stock confiscated or destroyed, 19 per cent had been prosecuted and fined, and 17 per cent had been ordered to close or move on. Ten per cent had been asked to pay bribes. The median bribe payment was R225 per bribe, small but significant in relation to a median turnover of R700 a month.

Respondents were well aware of the advantages of formalisation. As figure 8 shows, these were identified as: less harassment (30 per cent); cheaper stock/inputs and credit (17 per cent); the possibility of government aid (24 per cent); and a better image for marketing and tenders. Almost half of the sample (45 per cent) was considering registration, but clearly the disadvantages weighed heavily against it. Among the perceived disadvantages were: taxes (38 per cent), costs in relation to rewards (22 per cent), and red tape (7 per cent), though 24 per cent thought that their present compliance was sufficient, or saw no disadvantages in informal status.

Conclusions

Efficiency costs in the formal sector

It is clear from our survey results that regulation creates very significant efficiency costs in the South African economy. There is strong evidence, echoed by many other studies, to show that features of the regulatory environment discourage business growth and job creation in the formal economy.

Regulatory obstacles to the informal sector

Our research has also shown that, even though regulations may not be enforced in the informal sector, the regulatory environment acts as a barrier to development by keeping a large, energetic, and entrepreneurial group of black South Africans out of the formal economy. From the perspective of informal operators, the regulatory environment is a cliff – they stand at base, very aware of the advantages of reaching the higher ground, but equally aware that the cliff is too steep to be climbed.

Regulatory compliance costs

The unique contribution of SBP's survey has been to show that regulatory compliance costs are substantial, and to specify with some precision what these costs are in South Africa.

Based on the average recurring compliance cost per firm (see table 1) of R105 174, and our conservative estimate of 750 000 as the number of firms affected (see appendix) we estimate that aggregate recurring compliance costs for the formal sector amounted to R78,9 billion in 2004 – an amount equivalent to 6,52 per cent of GDP.

It is clear is that the aggregate of resources spent by formal business in South Africa on regulatory compliance is very large. These costs represent real resources, which have alternative uses. Businesses could employ the resources now used in complying with regulation for innovation and expansion, or improving their local and international competitiveness. The government could use some of the cost savings (and some of the income generated by the private sector in the rounds of spending and production stimulated by these savings) to improve public services or to reduce taxation. Moreover, countries that reduce their regulatory compliance costs increase their attractiveness to foreign direct investment.

Box 2: Total recurring compliance costs in relation to selected macroeconomic aggregates

- Total compliance costs were R78,9 billion in 2004
- 6,52 per cent of GDP in 2003 at R1 209,5 billion
- 2,8 per cent of total turnover in 2003 at R2791,9 billion (SARS)
- 16,5 per cent of the total wage bill in 2003 (Regional Services Council returns, 2003)
- 28 per cent of SARS revenue (2002–3)

It is worth reiterating that reducing the compliance costs of regulation does not pose the same kinds of political challenges or require the socio-political trade-offs as would reducing their efficiency costs. Simplifying procedures, making forms available online, and rationalising multiple requests for information or for proof of tax compliance could all make a significant difference to compliance costs without raising the hackles of any important interest group.

Box 3: Regulatory compliance costs are 'opportunity costs'

In 2004, South African firms faced around R79 billion in recurring regulatory compliance costs. The resources represented by this amount could have been used more productively than in complying with red tape.

Without abolishing any existing regulations, we could eliminate multiple requests for the same information, make forms shorter and clearer, and reduce the number of times in a year that forms have to be filled in. Let's assume that making compliance easier and simpler in these ways would reduce the costs of complying by half.

This would return resources worth about R40 billion a year to the South African economy. This sum is roughly the market capitalisation of some of South Africa's largest corporations. An 'extra' R40 billion could mean another company the size of Telkom, Anglo Platinum, Standard Bank, or MTN, and all the jobs, growth, and additional tax revenue that another corporate giant would create.

Alternatively, R40 billion a year could create around 2 million temporary jobs in labour-intensive construction every year,[5] could fund a basic income grant of R100 a head, or could simultaneously double the national education and health budgets.

Clearly, not all of the resources released by a reduction in regulatory compliance costs could or would be spent in one particular way. However, there is little doubt that a substantial proportion of the resources spent on regulatory compliance could be more effectively employed.

Compliance cost studies: international comparisons

It is not possible, based on existing data, to make systematic comparisons of compliance costs across countries. While there have been a number of studies, their coverage and methods differ so much that to compare the results too closely would be misleading. Nevertheless, it is interesting to look at South Africa's 6,52 per cent of GDP in the context of the available international comparisons.

During 1998–9 the OECD carried out a postal questionnaire compliance cost survey of between 300 and 1 200 businesses with fewer than 500 employees in eight European countries, Australia, and New Zealand. The basic approach was similar to that used in our survey, though only tax, employment, and environmental regulations were covered. The study also excluded businesses in agriculture and mining, as well as those without employees.[6] The key results in terms of compliance costs as a percentage of GDP are shown in table 3:

Table 3: Estimated regulatory compliance costs in some developed countries as a percentage of GDP	
Australia	3,0
Austria	3,8
Belgium	1,8
Finland	1,0
Iceland	1,3
New Zealand	2,8
Norway	2,8
Portugal	5,0
Spain	5,6
Sweden	2,2

Compliance cost surveys for developing and transition countries still seem to be quite rare. A very small-scale survey in Bulgaria among 20 firms with fewer than 100 employees suggested that compliance costs were of the order of 5 per cent of GDP. A similar exercise in Jamaica put compliance costs for firms with fewer than ten employees at 3 per cent of GDP. Another, in Uganda, put them much higher – as much as 11 per cent of GDP for all firms.

As table 3 suggests, South Africa's regulatory compliance costs appear to be significantly higher than those in any highly developed countries.

A growing body of research is showing that work to improve the regulatory environment for business should be a national priority. There are strong relationships between a good regulatory environment for business and economic growth. A 2002 study (by SBP and Bannock Consulting) of 10 developing countries including South Africa concluded that an appropriate regulatory environment was the single most important element of an economic growth strategy. World Bank research released in mid-2004 has found that many developing countries could increase their rate of economic growth by as much as 1,4 per cent a year if their regulatory environment ranking rose to equal that of the average country in the top quartile. The World Bank ranks South Africa higher than most developing countries, so we might expect a somewhat smaller, but still significant, positive impact on growth.[7]

Towards regulatory impact analysis

Many regulations are obviously necessary. But even among necessary regulations, there are probably many which are unnecessarily expensive to comply with. There are likely to be many other regulations where the costs exceed the benefits, and some which have no benefits at all. The cumulative impact of the regulatory environment is an important factor in determining a country's overall economic prospects.

Regulatory cost surveys are an important tool for deciding which regulations should be simplified, which should be scrapped, which are appropriate in their current form, and even which should be made stronger.

International experience suggests that the next steps could be:

- the creation of Regulatory Impact Analysis capacity in government that will advise lawmakers and regulators about the costs and benefits of proposed new regulation; and

- a systematic review of the existing regulatory environment.

As this report has shown, the socio-political costs of reforming the regulatory environment need not be high, while the rewards could be very large indeed. This is an opportunity to accelerate growth and development that South Africa cannot afford to miss.

Endnotes

1 World Bank, Doing Business in 2005: Removing Obstacles to Growth, Washington, 2004.

2 Regulation also results in costs for government both as it applies to government's own activities (as in the case of employment law) and in the costs of staff engaged in administering the regulations themselves. Costs to the public sector have not been measured in this study. Evidence from the United Kingdom suggests that the cost of administering regulations is equivalent to around 20% of the cost of complying with them.

3 The question was phrased in this way to avoid putting pressure on respondents to admit to avoidance in their own business.

4 The median is the value at the midpoint of a sample of values ordered by size. We make extensive use of medians rather than arithmetic averages in analysing the informal sample because they are far less influenced by extreme values.

5 CDE, Labour-intensive public works: towards providing employment for all South Africans willing to work, April 2003.

6 C Cordova-Novion and C De Young, The OECD PUMA Multi-country Business Survey – Benchmarking the regulatory and business environment, in C Evans, J Pope and J Hasseldine (eds), Tax Compliance Costs: A Festschrift for Cedric Sandford, 2001

7 World Bank, Doing Business in 2005, Washington, 2004

8 L Schlemmer and J Hudson, Entrepreneurship and Expanding the Business Sector in South Africa, Research report prepared for CDE, 2002

9 See L Schlemmer in association with MarkData (Pty) Ltd, Rules, Regulations and the Private Sector, Research report prepared for SBP, 2004.

10 Statistics South Africa, Labour Force Survey, March 2004.

Appendix: Survey method

Sampling

Though costly, personal visits to businesses by trained interviewers were used to secure a high response rate and reasonable coverage for questions on a complex subject area. Firms were selected at random from telephone and other directories, and the sample stratified by local authority district to ensure full geographical coverage across the country. Multiple contacts were required, often by telephone, to enlist co-operation, prepare respondents for the information required, and check and clarify responses. Pilot enquiries revealed that, despite guarantees of confidentiality, many interviewees were not willing to divulge turnover or employment numbers, and it was decided to allow them to indicate the data in terms of broad size bands. This hampered some of the detailed analysis later, but was regarded as necessary to obtain adequate numbers of respondents.

The total sample comprised 1 794 enterprises (to avoid double counting, subsidiaries were not interviewed). The main sample of 1 108 cases included formal businesses in all sectors, including agri-business but excluding farms. The use of directories may have meant that the newest and smallest businesses were underrepresented. Semi-informal and mini-micro firms were largely excluded deliberately to ensure that the sample included only formal businesses. The main sample was supplemented by a special sample of major corporations (32 cases) which, because of their small number, would not have been adequately covered by our random procedure. The large enterprises were subsequently integrated into the main sample (the main integrated sample) and these 1 140 enterprises were used for most of the analysis in this headline report. In addition, there were special samples of commercial farms (100 cases); 240 cases of firms in selected case study sectors, including agri-processing, information technology, and pharmaceuticals; a sample of 164 emerging black-owned businesses; and a sample of 150 informal sector enterprises. There were particular difficulties in identifying firms in the latter two special samples, and extensive use was made of snowballing, in which respondents were asked to identify other similar businesses. With the exception of a brief description of the findings from the informal sector, the special samples are not analysed in this report, but will be the subject of subsequent reports.

Table A: Sample and subsample sizes: main sample, including corporations

Sector	N	Turnover	N	Employees	N
Agriculture, forestry and fishing	18	< R1 million	461	< 5	321
Mining, manufacturing, power and water	271	R1m – < R5m	325	5– <10	272
Construction	80	R5m – < R10m	88	10– < 50	389
Trade	408	R10–<R25 m	87	50–<100	74
Transport, storage and communication	28	R25–< R100 m	59	100–<200	29
Finance	240	R100 m – < R500 m	19	200–<500	22
Community and personal services	66	R 500 m – <R 1 billion.	10	500 plus	33
Tourism	29	Over R 1 bn	20	Not given	71
Total	1140	Total	1140	Total	1140

Weighting

Details of the raw (unweighted) integrated sample of 1 140 cases with numbers by activity sector and employee and turnover size bands are given in table A.

The raw data had to be weighted according to the proportions of formal enterprises by employment size band in the whole business population in South Africa to compensate for the under- or over-representation which inevitably occurs in small random samples. This presented a major difficulty, because reliable data on enterprise size distributions and numbers do not exist. These numbers were estimated from the available Department of Trade and Industry estimates for 2004 together with other estimates as described below. The results, which we still believe underestimate the relative share of small formal firms, nevertheless allow for our exclusion of semi-formal operations. The final size distributions used for weighting the integrated sample are given below.

Table B: Estimates of the size breakdown of active formal sector companies in South Africa

Size categories: employee numbers: Proportions	Reconciliation of estimates of Christo Botes of SBDC/Business Partners, updated to 1999	DTI (CIPRO) estimates of active companies of known size, 2004	Final reconciliation for purposes of weighting the integrated sample
< 5 employees	65,3%	49,8%	57,5%
5-9	26,9%	40,0%	33,0%
10 – 49	6,2%	7,6%	7,6%
50 –99	1,1%	1,6%	1,0%
100 –199		1,1%	0,7%
200 – 499	0,5%		
500 + employees			0,3%
Total (differences due to rounding)	100%	100%	100%

Grossed-up estimates for the economy

The calculation of the sum total of regulatory compliance costs for the economy as a whole from our sample results required an estimate of the total population of formal enterprises in South Africa. DTI (CIPRO) estimates put this total (for active firms) at 428 540 (June 2004). This is well below the number of VAT registrations at 538 000, and is clearly too low, since we know that many formal businesses remain below the threshold. In 2002 Schlemmer and Hudson reconciled the DTI estimates with earlier figures to produce a total of 1 300 000 formal enterprises.[8] From this figure, it is necessary to deduct the semi-formal operations which were excluded from our sample. We consider that a conservative estimate for the number of formal enterprises would be 750 000.[9]

To arrive at an estimate of total compliance costs, we multiplied the average compliance costs per firm from our survey (R105 174: see table 1) by 750 000, which yields a total of R79,2 billion. This is equivalent to 6,6 per cent of GDP.

The informal sector

There appear to be no reliable data on the number of informal businesses (defined as not registered, and not liable for business income tax). The Labour Force Survey shows nonfarm employment in the informal sector as 1 834 000.[10] The number of enterprises would be less than this, since from our survey we know that about half had between one and five employees. Subtracting employees of entrepreneurs suggests that there are roughly 970 000 fully informal entrepreneurs in South Africa.

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SBP is an independent not-for-profit private sector development and research organisation, promoting strategic partnerships and a better policy, regulatory and operational environment for business growth in Africa. Our work combines research, advocacy, and practical business development programmes. Our projects are supported by the private sector and a variety of donors. SBP (originally the Small Business Project) is registered in South Africa as a Section 21 company.

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