

Annex A

The importance of inspections and compliance

Relevance of inspections and enforcement issues

Designing and adopting sound regulations is of little use if they are not complied with – and, to promote such compliance, appropriate systems and measures need to be in place, including effective and efficient regulatory inspections and enforcement. International experience and research have shown that this is unfortunately often far from being the case, and that inspection and enforcement regimes are often simultaneously burdensome and ineffective (see e.g. Hampton 2005; World Bank Group, 2011; OECD, 2012, 2014).

Such a combination of ineffectiveness at achieving the stated goals of regulation (safety, health, or any other type of public benefit and welfare), and of considerable economic burden (loss of time, turnover and resources for active businesses – and decreased investment because of regulatory uncertainty), is particularly sharply in evidence in “transition” economies, notably those of countries that used to be part of the former Soviet Union. The reasons for this are many, and include several traits that have been “carried over” from the previous command-economy system:

Regulatory regimes that are highly prescriptive and cover far more aspects of economic activity than accepted good practice – resulting in more fields and types of regulatory control

A large number of institutions in charge of regulatory control and enforcement, with relatively high staffing levels – which mechanically drive a larger number of inspections, a high degree of fragmentation, as well as an important “constituency” that tends to resist changes towards a different (somewhat “lighter touch”) system.

Crucially, an approach to regulatory enforcement and a vision of regulatory drivers that are founded on an “adversarial” approach to duty holders (businesses, and also citizens) – this approach emphasises deterrence rather than trust, and reflects a “presumed guilty” view.

In addition, in a number of countries, these aspects are compounded by an overall weak rule of law, insufficient compensation for inspectors, and deep ethical issues in public administration, and result in inspections being primarily an instrument of corruption.¹ This, of course, results in inspections that also completely cease to fulfil their stated function – ensuring that the goals of regulations are achieved.

1. See for instance, successive survey reports published by the IFC in Ukraine, Tajikistan etc., for e.g., :
www.ifc.org/wps/wcm/connect/RegProjects_Ext_Content/IFC_External_Corporate_Site/TJBEE_Home/Overview/Survey/ and
www.ifc.org/wps/wcm/connect/RegProjects_Ext_Content/IFC_External_Corporate_Site/USPP_Home/ProjectMaterials/PMSurveys/.

Improving regulatory inspections and enforcement regimes is thus a priority that corresponds to a set of objectives for governments: reducing the economic burden and thus facilitating investment and growth and maximising the regulatory effectiveness in terms of social welfare with constant or decreasing state resources (particularly important in times of economic crisis. In “transition” economies, reducing corruption (that contributes to both objectives) is also often specifically articulated as a priority. More deeply, inspection regimes that are more effective, efficient and transparent (and, of course, not corrupt) strongly contribute to reinforcing the legitimacy of public action and authorities, and this in turn drives improved compliance.

Drivers of compliance: striking the right balance

A common view underpinning “heavy handed” inspection and enforcement approaches is that people comply with rules only if they are under supervision and there is a realistic threat of punishment for violations. This “dissuasion-based” view results in efforts to inspect each and every establishment as often as possible. It is found in every country around the world, but is particularly strong in post-Soviet regulatory regimes, fueled by a history of hostility towards and suspicion of private initiative. Business operators are held to be pure rational calculators, only likely to comply if the costs of non-compliance are high, and punishment close to certain.

In fact, decades of research and international examples show decisively that this view is mistaken, and that such an approach results in disappointing compliance levels. Across a number of countries and fields, it has been found that compliance is fostered by at least three types of drivers: moral values, legitimacy of authorities, and rational calculations (dissuasion) – but that dissuasion appears to be the weakest of the three. In addition, even though inspections and enforcement can promote compliance through dissuasion, when they are perceived as excessive, heavy-handed, unethical or otherwise not transparent, they produce negative effects in terms of compliance that tend to outweigh whatever benefits dissuasion may have produced (see e.g. Tyler, 2003; Kirchler 2007; Blanc et al., 2015).

Moral values are one of the strongest drivers of compliance. Though primarily formed during childhood, they can be influenced through public policy and regulatory interventions – but on the long term (e.g. through school education). For this reason, and because moral values are not always easily connected to regulations, it is not possible to design interventions to promote regulatory compliance that would rely exclusively on moral values.

Dissuasion is, clearly, a driver of compliance that is more “straightforward” to use in regulatory interventions – but it has important limitations. First, even to the extent that probability of detection and fear of punishment do play a role, their effects are mediated by the values of the regulated subjects (see Kirchler, 2007) – meaning that those whose moral values already tend to support compliance will experience a stronger dissuasion effect, but those whose moral values do not will be far less influenced (whereas these are precisely those that *need* to be influenced). Second, really strong dissuasion tends to have considerable costs – both in terms of finances and freedom (personal and economic). In practice, strong deterrence is impossible to achieve in most cases: the resources required would be far too high (in a world of limited resources, society cannot commit enough resources to deterring violations in each and every regulatory field), and the intrusion on privacy and limitations of individual freedoms would be far too high (see Tyler, 2003). Finally, when efforts at dissuasion are felt to be excessively intrusive or even abusive

(indiscriminate visits and checks, as well as sanctions imposed regardless of the risk level, disrespectful and/or unethical behaviour by inspectors, requirements that hinder initiative too strongly etc.), they tend to negatively affect procedural justice, which in turn weakens what is probably the strongest of compliance drivers. This phenomenon is particularly well in evidence in post-Soviet states, where extensive regulations and heavy enforcement are not accompanied by high compliance, but rather by a general disrespect of rules, which tend to be seen as being tools of oppression or graft, and not as instruments of safety and social welfare.

Indeed, the degree to which regulated subjects (citizens, business operators...) find authorities and rules legitimate has consistently been found to be one of the strongest drivers of compliance (possibly the strongest one). Most importantly, it is also the one that is most easily influenced (strengthened, or weakened) by the actions of public authorities. In turn, the strongest element influencing legitimacy has been found to be procedural justice – the extent to which actions of public authorities are perceived by those whom they affect as *fair*, not in terms of their results, but of the process which they follow. Key elements of procedural justice are fairness of interpersonal treatment, behaviour by authorities that fosters motive-based trust, giving duty holders a real voice in the process. It entails respectful treatment of duty holders, ethical behaviour and self-imposed limits on discretionary power (non-biased and consistent decision making), and demonstrating that regulated subjects are listened to and their arguments, issues, requests etc. carefully considered. When procedural justice is high, the legitimacy of authorities increases, and with it the legitimacy of the rules they edict and the decisions they take – and with increased legitimacy comes increased compliance (see Tyler, 2003). In addition procedural justice, and the legitimacy it fosters, are long-term drivers of compliance, and largely self-sustaining. They do not require an increase in resources – but a change in behaviours and approaches, in how authority is exercised, which may be very significant.

It is essential to design an approach to regulatory inspections and enforcement that finds the right balance between achieving the needed level of dissuasion, and fostering procedural justice. Repeated inspection visits, even handled in the most respectful and fair way possible, will still produce a feeling of accumulated burden which will reduce the feeling of procedural justice (one tends to feel unfairly treated when control is too frequent). This negative effect on compliance gets far worse when enforcement methods are not optimal in terms of behaviour, but feature abusive discretion, lack of transparency, disrespectful treatment, refusal to hear the duty holder's views or take them into account etc. Unfortunately, “oppressive enforcement and harassment” are quite frequent in regulatory inspection and enforcement practices, and this is a major factor in the failure of regulations to produce their desired effects, because of resistance by regulated subjects leading to low compliance. An optimal system should strike the right balance to fit all the different categories of regulated subjects – the majority which tend to comply voluntarily if the preconditions for compliance exist (legitimacy in particular, as well as knowledge, and regulations that are realistically within their means in terms of complexity and costs, investment etc.), as well as a minority which tend to be “rational calculators” (see Voermans, 2014; Elffers, 1997). For them, an element of dissuasion is essential to make them the “right” choice – and this dissuasion will also ensure the majority of “voluntary compliers” that there is a “level playing field” – but this dissuasion should not become so burdensome that it alienates the majority.

Best practice principles and fundamental elements for reform

Inspections and enforcement apply across a variety of regulatory fields: technical safety inspections (themselves quite diverse: food hygiene, environment, OSH, etc.), revenue inspections (taxes and customs), and often a number of other regulatory compliance checks (on employment law, state language, gambling, currency regulations etc.). Institutions conducting inspections range from small specialised outfits with a few staff, to major structures with dozens of thousands of employees (in particular tax inspectorates). Institutions, their status, governance etc. are likewise diverse. On the other hand, there is a considerable level of agreement on what good practices for inspections are, and on how to conduct reforms to improve existing regimes.

Box A.1. The OECD Best Practice Principles for Regulatory Enforcement and Inspections

1. **Evidence-based enforcement.** Regulatory enforcement and inspections should be evidence-based and measurement-based: deciding what to inspect and how should be grounded on data and evidence, and results should be evaluated regularly.
2. **Selectivity.** Promoting compliance and enforcing rules should be left to market forces, private sector and civil society actions wherever possible: inspections and enforcement cannot be everywhere and address everything, and there are many other ways to achieve regulations' objectives.
3. **Risk focus and proportionality.** Enforcement needs to be risk-based and proportionate: the frequency of inspections and the resources employed should be proportional to the level of risk and enforcement actions should be aiming at reducing the actual risk posed by infractions.
4. **Responsive regulation.** Enforcement should be based on “responsive regulation” principles: inspection enforcement actions should be modulated depending on the profile and behaviour of specific businesses.
5. **Long term vision.** Governments should adopt policies on regulatory enforcement and inspections: clear objectives should be set and institutional mechanisms set up with clear objectives and a long-term road-map.
6. **Co-ordination and consolidation.** Inspection functions should be co-ordinated and, where needed, consolidated: less duplication and overlaps will ensure better use of public resources, minimise burden on regulated subjects, and maximise effectiveness.
7. **Transparent governance.** Governance structures and human resources policies for regulatory enforcement should support transparency, professionalism, and results-oriented management. Execution of regulatory enforcement should be independent from political influence, and compliance promotion efforts should be rewarded.
8. **Information integration.** Information and communication technologies should be used to maximise risk-focus, co-ordination and information-sharing – as well as optimal use of resources.
9. **Clear and fair process.** Governments should ensure clarity of rules and process for enforcement and inspections: coherent legislation to organise inspections and enforcement needs to be adopted and published, and clearly articulate rights and obligations of officials and of businesses.
10. **Compliance promotion.** Transparency and compliance should be promoted through the use of appropriate instruments such as guidance, toolkits and checklists.
11. **Professionalism.** Inspectors should be trained and managed to ensure professionalism, integrity, consistency and transparency: this requires substantial training focusing not only on technical but also on generic inspection skills, and official guidelines for inspectors to help ensure consistency and fairness.

The OECD has compiled, based on international experience, a list of eleven good-practice principles for inspections and enforcement: evidence-based enforcement, selectivity, risk focus and proportionality, responsive regulation, long term vision, co-ordination and consolidation, transparent governance, information integration, clear and fair process, compliance promotion, Professionalism (Box A.1).

To implement these, the fundamental approaches on which reform should be based include:

- Risk focus and risk proportionality: inspection resources and targeting should be based on the level of risk presented by activities/establishments – and enforcement responses should be proportional to the risks identified during inspection visits.
- Co-ordination and consolidation: avoid duplication and overlaps in inspection mandates and missions – share information between different inspection fields
- Better inspection methods: tools (like checklists), training, guidelines, etc. should all contribute to more transparency and predictability in enforcement decisions, as well as more risk proportionality and more attention to compliance promotion.
- Compliance focus: all the work of inspectorates should be geared at improving compliance and public welfare outcomes – this means a major focus on information, outreach, guidance etc. – and a change in how inspectors interact with businesses.
- Governance and performance management: institutional design and structures, management, internal processes and procedures, compensation, performance management etc. should all be aligned with reform objectives, compliance promotion goal, and contribute to transparency, effectiveness, efficiency etc.

Shared information systems for inspections: characteristics and benefits

Risk-based planning cannot be done without each agency having data on all objects under supervision, which is costly and difficult to update – while, at the same time, because many of the risk dimensions are correlated, and because a non-compliant business tends to be thus in several areas, inspectorate would be able to improve their risk analysis if they also had data from other inspectorates. In addition, many inspectorates (even in OECD countries) have been found not to have proper information systems in the sense of systems allowing them to plan their activities based on risk, and to record the inspections results – setting up a system for each of these separately, and “populating” each separately with data on all objects, is far more costly than setting up a joint system. All these points speak strongly for setting up as much as possible joint information systems shared by most or all inspectorates.

The information system should be built on a database that includes the following data:

- List of all business entities and of all establishments (not only all companies/businesses, but also all separate premises) in the country.
- For each establishment, have data on a set of relevant parameters corresponding to different risk factors, some “general” risk parameters generally relevant to all or most types of inspections (e.g. size, volumes handled, type of technology or

process, etc.), and other more specific ones grouped by risk dimensions (e.g. food safety, workplace safety etc.).

- List all inspections and their results.
- Automatically generate risk ratings for each business and establishment.
- Automatically generate inspections selection and schedule.
- Filter and analyse data reporting.

More advanced systems can also incorporate functions to plan activities inside the inspectorate and manage processes, have online checklists, etc. (Blanc, 2012).

Best practice today dictates that various inspectorates should ideally co-ordinate their activities to ensure that all relevant risks are properly addressed during a joint inspection process. However, experience shows that inspections tend to be uncoordinated, unplanned and carried out in silos, regardless of industry or jurisdiction. Typically inspecting organisations do not share much information or regularly communicate. Information technology has a key role in improving efficiency, transparency, and accountability in business inspections. A select number of jurisdictions have made efforts to implement inspection management solutions that are shared across multiple inspectorates, albeit with various levels of success. Online research and a series of in-depth interviews with government officials who participated in this study showed that a successful SIMS implementation yields:

- Improved targeting through a better identification and follow up of risks.
- Decreased administrative burden for businesses and entrepreneurs to comply with regulation.
- Increased quality and effectiveness of inspections leading to improved regulatory compliance.
- Improved internal efficiency and reduced administrative costs for governments.
- Increased transparency of inspection operations for businesses and citizens leading to a decrease in corruption.

These benefits usually result from:

- Gathering and consolidating more consistent and comprehensive information on enterprises subject to inspection.
- Streamlining the inspection process to increase inspector efficiency.
- Formalising policy and procedures to ensure consistency.
- Automating and supporting decision-making to reduce subjectivity in operations and maximise the use of resources.
- Sharing information across inspectorates to co-ordinate inspection scope, improve preparation and outcomes, as well as reduce the inspection burden of individual inspectorates.
- Providing public access to relevant information leading to increased transparency and accountability.

- Basic solutions incorporate information about businesses and entrepreneurs, their characteristics (e.g. locations, size, industry, etc.) and previous inspection results to allow for simple planning of future inspection activities. These systems typically provide a full inspection history by business and location and use a checklist to obtain consistency across inspections however, there is typically very limited automation.
- Intermediate solutions have functionality to trigger follow-up activities based on the outcome of an inspection and allow for automated integration of inspection practices across inspectorates. They are ideally integrated with government business registries or other sources of enterprise information.
- Advanced solutions include a variety of other features and functions including:
 - Risk-based inspection planning allows for the scheduling and planning of inspections based on a risk assessment of the business that includes key information such as size of the business, previous inspection results, industry, geography, and data from other inspectorates or government information sources.
 - Automated or real-time integration with other information sources, which generally fall under two broad categories: *i*) registry information (e.g., business/company registration information, licences and permits); and *ii*) risk information (e.g., business/company risk based on its activities and profile, results of inspections or reports from other inspectorates).
 - Comprehensive mobile inspection capabilities include tools and technologies that give inspectors the ability to view schedules and inspection records as well as record inspection results while onsite.
 - Performance management capabilities enabled through business analytics is aligned with risk-based planning and provides capabilities for inspectorates to monitor the efficiency and output of their inspection programme and individual inspectors.
 - Public portal capabilities involves providing access to businesses and the general public to view inspection requirements and results, submit complaints, and appeal an inspection (Wille and Blanc, 2013).

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