FINAL REPORT

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Making Regulatory Impact Statements more effective

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1. INTRODUCTION

The Property Council is concerned that Australia's regulatory review process as embodied in Regulation Impact Statement (RIS) requirements has not been used to its full potential in the design of efficient regulation. Specifically, the Property Council has noted:

- The poor average quality of the RISs prepared by regulators, in terms of the data and assumptions used, and the quality of the analysis undertaken;
- A lack of standardisation and consistency in the presentation of RISs across governments; and, relatedly,
- An overall lack of transparency.

I have been asked to assess how the effectiveness of the RIS framework that is currently applied in Australia can be improved. The aim of this paper is to formulate a number of initial, high-level recommendations that can serve as a template for the further development and improvement of the RIS process at the Commonwealth, as well as at State and Territory level.

1.1. REGULATORY IMPACT STATEMENT

Regulatory Impact Statements (RISs), also known as Regulatory Impact Analyses or Regulatory Impact Analysis Statements in other jurisdictions are a decision tool for:[1]

- Systematically and consistently examining selected potential impacts arising from government action; and
- Communicating the information to decision-makers.

More specifically, one official definition of an RIS is as follows:[2]

> *… a document prepared by the department, agency, statutory authority or board responsible for a regulatory proposal following consultation with affected parties, formalising and evidencing some of the steps that must be taken in good policy formulation. It requires an assessment of the costs and benefits of each option, followed by a recommendation supporting the most effective and efficient option. It must be incorporated into the assessment process used by all areas of government responsible for reviewing and reforming regulations.*

1 For simplicity I henceforth only use the Australian term 'RIS' to describe a similar framework in other countries.

2 Office of Regulation Review 1998, *A guide to regulation (Second edition).*

Countries which have adopted RIS frameworks as a means of enhancing the quality of regulatory decision-making include Australia, Canada, Denmark, Germany, Italy, Japan, Korea, Mexico, New Zealand, Norway, Poland, the United Kingdom, and the United States.[3] In Australia, they have been adopted at both the Commonwealth and State/Territory levels.

1.2. REGULATORY FAILURE

The fundamental objective of undertaking an RIS (including associated governance and associate processes) is to reduce the risk of 'regulatory failure'.

It is uncontroversial that regulation, in terms of market intervention, invariably imposes costs of its own, and that these can be very high. The direct costs of regulation relate to legal, administrative, compliance and monitoring costs of enforcing rules, such as building regulations. However, regulation can also have other indirect or second-order effects depending on how they affect the prices of goods and services produced by the regulated industry and how these changes in prices affect the rest of the economy.

Regulatory failure refers to the situation where a regulation is approved even though the overall costs of a regulation (including the direct costs and negative second-order effects) exceed the benefits of the regulation. Regulatory failure results from misdirected regulatory intervention and poor regulatory processes and institutions. In the longer run, this reduces society's welfare, for instance, if the costs of requiring new buildings to meet onerous requirements exceed the benefits they are likely to deliver. Tools such as RISs have the purpose of reducing the incidence of regulatory failure by helping government departments to filter out the regulations where the costs are likely to exceed the benefits.

1.3. STRUCTURE OF THIS PAPER

This paper is structured as follows:

- In Section 2 I provide an overview of the current Australian Commonwealth's RIS framework, outlining its strengths and weaknesses based on my analysis of a sample of Australian RISs.
- In Section 3 I review the findings from a comparison of RIS approaches undertaken internationally, and develop a number of options that could be adopted in Australia for improving RIS processes.
- Section 4 provides a summary and recommendations.

3 OECD 2004, *RIA Inventory*.

2. AN ASSESSMENT OF THE AUSTRALIAN RIS FRAMEWORK

In this section I discuss current Commonwealth and State/Territory government RIS obligations, and the strengths and weaknesses of the current framework. My starting point in the analysis set out below is the Commonwealth RIS framework, since this represents the best developed framework. To identify the weaknesses of current RIS processes, I draw on examples from the Office of Regulatory Review's reports, a survey of 32 RISs, and the experiences of the Property Council.

2.1. COMMONWEALTH AND STATE OBLIGATIONS AND GOVERNANCE FRAMEWORK

In Australia, the Office for Regulation Review (ORR), a part of the Productivity Commission, is the independent statutory body charged with providing advice to regulation making bodies, and vetting the compliance of regulatory agencies and government departments with RIS requirements. Associated with its RIS responsibilities, the ORR also reports annually on compliance with the Commonwealth Government's RIS requirements.

At the Australian Commonwealth level, an RIS is mandatory for all reviews of existing regulation, proposed new or amended regulation and proposed treaties involving regulation which will directly affect business, have a significant indirect effect on business, or restrict competition. What constitutes 'significant' regulation depends on a case-specific evaluation by the ORR.[4] RIS requirements at the State/Territory level are also subject to 'significance' criteria. The RIS requirements apply to all Australian Government departments, agencies, statutory authorities and boards that review or make regulations, including agencies or boards with administrative or statutory independence.

Current Australian ORR guidelines for production of an RIS prescribe the following information requirements that should be met by the production of an RIS:[5]

1. Problem or issue identification;
2. Specification of the desired objectives in relation to the underlying problem;
3. Identification of options;
4. Assessment of impacts of each option;
5. Consultation;
6. Conclusion and preferred option; and

4 The ORR evaluates the significance of a proposal by considering the nature and magnitude of the proposal (and the problem) and second, its impacts on affected parties.

5 Office of Regulation Review 1998, *A guide to regulation (Second edition).*

7. How the regulation should be administered, implemented and enforced, and how the recommended option will be monitored.

These guidelines are fairly comprehensive in scope in setting out the basic requirements for policy analysis. However it is worth noting that while an RIS is required to show a net benefit to justify an option, quantification is not compulsory.

A government department or regulatory agency is assessed to be compliant with RIS requirements if:

- An RIS was prepared to inform the decision maker at the policy approval stage (where one was required) and the analysis contained in the RIS meets the Government's adequacy criteria; and

- The RIS prepared at the decision-making stage (where one was required) was tabled in the Parliament or otherwise made public and the analysis meets adequacy standards.

An RIS is classified as adequate depending on compliance with a checklist of seven criteria:

1. Is it clearly stated in the RIS what is the fundamental problem being addressed? Is a case made for why government action is needed?

2. Is there a clear articulation of the objectives, outcomes, goals or targets sought by government action?

3. Is a range of viable options assessed including, as appropriate, non-regulatory options?

4. Are the groups in the community likely to be affected identified, and the impacts on them specified? There must be explicit assessment of the impact on small businesses, where appropriate. Both costs and benefits for each viable option must be set out, making use of quantitative information where possible.

5. What was the form of consultation? Have the views of those consulted been articulated, including substantial disagreements? If no consultation was undertaken, why not?

6. Is there a clear statement as to which is the preferred option and why?

7. Is information provided on how the preferred option would be implemented, and on the review arrangements after it has been in place for some time?

The ORR will advise the department/agency and decision-maker accordingly of their non-compliance. The agency's or department's non-compliance is subsequently identified in the ORR's Annual Report, *Regulation and its Review.* There are no further legislated repercussions. Thus, the failure to comply with RISs does not affect the validity of regulation, as it is still up to Cabinet/Government to determine whether to dispense with RIS requirements, postpone policy approval, or require subsequent preparation. In essence, this means that the only sanctions for non-compliance at the moment are a (weak) form of 'public shaming'.

2.2. STRENGTHS AND WEAKNESSES OF THE CURRENT AUSTRALIAN RIS FRAMEWORK

My discussion of the strengths of the current RIS framework will be brief as they are widely acknowledged. A good summary of the strengths of the current system is provided by the Productivity Commission which notes the following characteristics of the RIS framework:[6]

- Its wide scope, both in terms of the regulatory instruments and types of bodies covered;
- RIS requirements apply to reviews of existing regulations as well as to new proposals;
- A cost-benefit methodology is recommended and set out in ORR Guidelines but at the same time is flexibly applied based on the principle of proportionality;
- Independent assessment of RISs by the ORR; and
- The monitoring and reporting of compliance (where Australia is well ahead of most countries).

In principle, therefore, the current RIS framework is a sound one, in terms of its coverage and scope, as well as governance arrangements. However, these high-level findings do not translate into a sound application in practice.

As is set out below, the application of the RIS framework and associated processes, both at a Commonwealth and a State/Territory RIS level, suffers from a significant number of weaknesses. Because of the minor variation that exists between State and Territory regimes, there has been scope for some jurisdictions within Australia to experiment with different features of the RIS framework from which the Commonwealth can learn. The areas where some State/Territory RIS frameworks are superior to the Commonwealth framework are identified in Section 3, which also reviews the practices of overseas jurisdictions.

6 Argy, S. and M. Johnson 2003, *Mechanisms for improving the quality of regulations: Australia in an international context,* Productivity Commission Staff Working Paper.

Below I detail the weaknesses in the current system. They reflect the experiences of the Property Council, as well as my findings from a sample of 32 RISs, data from annual reviews by the ORR, and specific critiques of property sector-related RISs.

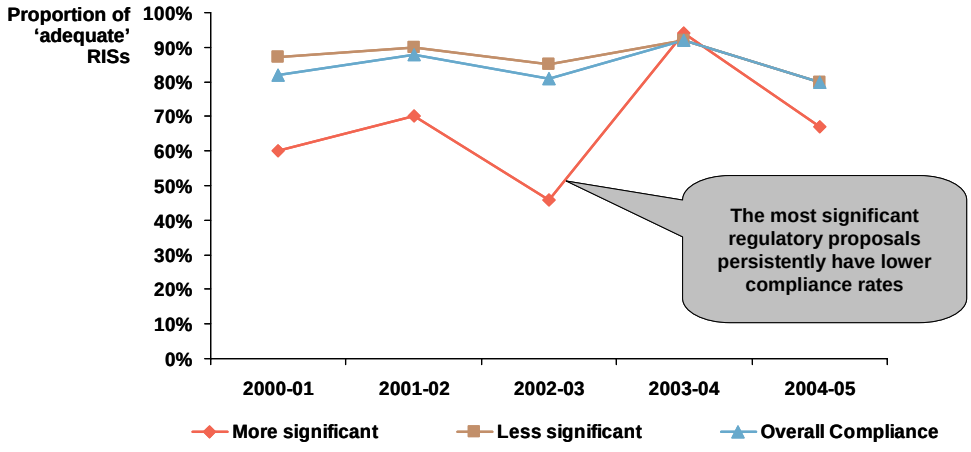
2.2.1. Lack of integration of RISs into the decision-making process

One of the serious shortcomings of the RIS framework at both the State and Commonwealth levels is the lack of integration of RISs into the decision making process.

There are only very limited sanctions for non-compliance with RIS requirements at both Commonwealth and State levels (with the exception of the ACT, see Section 3.1). Where Departments and regulatory agencies do not comply with a requirement to produce an RIS, this fact is noted to the relevant Minister and the lack of compliance is subsequently noted in the ORR's annual review. In other words, current sanctions for non-compliance are limited to a form of 'public shaming', but do not hinder the progress of the regulation being proposed.

The lack of serious sanctions for non-compliance is only part of the problem, because, as is set out below, the quality of RISs judged as 'adequate' is based on a standard that is low to begin with. However, there is also evidence that the lack of sanction for non-compliance has led to an under-utilisation of the RIS as a serious decision-making tool. For instance, according to ORR annual review statistics, the most significant regulatory proposals also have the lowest RIS compliance rates (see Figure 1). This is of concern because it is precisely those regulations, which are likely to have the broadest ranging impacts, which should be subject to greater scrutiny

Figure 1: RIS Compliance at the Decision Making Stage



Source: ORR, Regulation and its Review 2004-05, p.XVII

Therefore, the **rate** of compliance itself is a less fundamental issue than improving the standards according to which RISs are evaluated. The same rates of compliance accompanied by an improvement in the quality of analysis contained in RISs would still constitute a significant improvement in the RIS framework. However, I note that the measures I propose in Section 3 to better integrate RISs into decision-making are also designed to improve compliance rates in the longer term by increasing the incentives of regulators to apply RISs appropriately.

In its 2003-2004 annual review, the ORR specifically linked difficulties with compliance with the preparation of RISs late in the policy development process and the poor integration of the RIS requirements into policy development processes.[7] More recently, the Taskforce on Reducing the Regulatory Burden on Business (the 'Regulation Taskforce') released its report to the Prime Minister and Treasurer. It also summarised its survey of ORR reports as follows:[8]

> *In many cases, RISs appear to have been an afterthought, merely justifying decisions already taken.*

This also reinforces the point that the lack of integration of RISs into decision-making is the more fundamental problem that underlies compliance issues.

2.2.2. Quality of analysis in RISs is poor

The Property Council has noted the, on average, poor quality of the RISs it has scrutinised in its dealings with regulators.[9] As set out below, these findings were also substantiated in my survey of 32 RISs from a variety of industries. I also present a more detailed critique of a number of property sector related RISs, which the Property Council has drawn to my attention.

7 Office of Regulation Review 2004, *Regulation and its review 2003-2004,* p.2

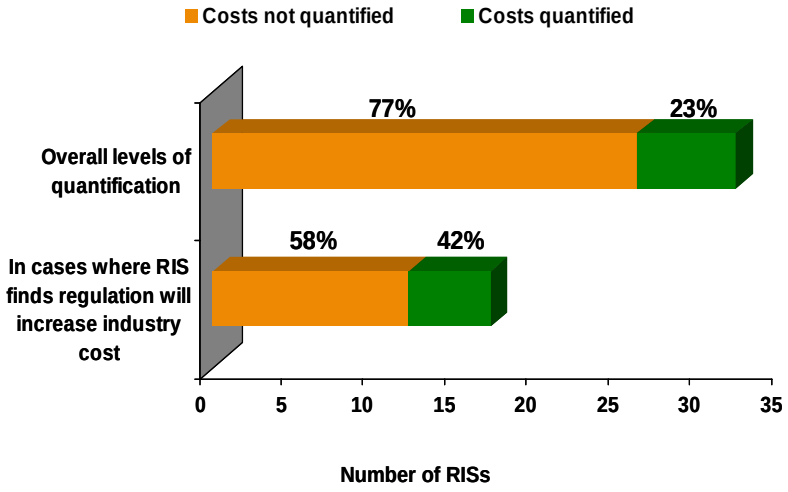
8 Regulation Taskforce 2006, *Rethinking regulation,* Report to the Prime Minister and the Treasurer, Canberra, p. 155. The Taskforce was appointed by the Prime Minister on 12 October 2005 to identify practical options for alleviating the compliance burden on business from Government regulation.

9 Note that these are RISs which were already judged as 'adequate' by the ORR.

Sample of RISs

The data sample of 32 RISs that I looked at was drawn from the RISs prepared by Commonwealth departments relating to regulatory proposals in the last financial year (2004-2005).[10] Figure 2 documents the proportion of RISs, which quantify the costs associated with new regulations. It is important to note, that these costs do not reflect the *economic* costs of a regulation, for instance compliance costs. Rather, they relate to fees and other charges directly levied by the regulator to recover the costs from the purported beneficiaries of the regulation. Despite this qualification, 77 per cent of RISs in the sample did not attempt to quantify the costs of regulation. In particular, compliance costs were rarely quantified. Furthermore, there was frequent use of vague language in the RISs when discussing costs and benefits.

Figure 2: Proportion of RISs which quantify costs in industry

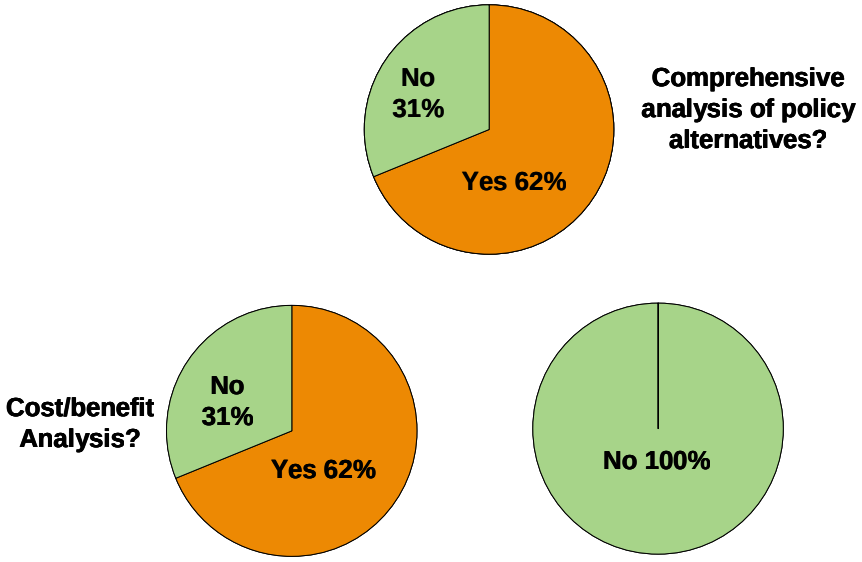


Source: CRA Analysis, sample size: 32

Around a third of RISs in the sample did not analyse policy alternatives (Figure 3). This is despite the fact that according to the ORR's own reporting, the adequacy standard for RISs has been progressively increased each year since the new requirements were introduced in 1997-98.

10 Specific industries affected by the regulations covered in my RIS survey were aged care, the film industry, fisheries, the maritime industry, insurance, sports, telecommunications, meat and livestock, banking and financial services, aviation, education, motor vehicles, petroleum, and agriculture. In addition the RIS survey also included regulation with general impacts comprising taxation, bankruptcy law, trade practices and workplace relations regulation.

Figure 3: Extent of analysis in RISs



Source: CRA Analysis, sample size: 32

The experience of the Property Council

In its experience scrutinising RISs specific to building regulation, the Property Council has also noted a number of serious deficiencies in the content of RISs. Specific examples from critiques of building industry RISs prepared by the Property Council are as follows:

- Outdated data relied on in the analysis: For instance, the statistics used to support proposals date from a Draft RIS for a proposal to increase the energy efficiency requirement for houses ('Energy Efficiency for Houses RIS') relied on data from 1998, which means they were 6 years out of date at the time of drafting the RIS.[11]
- Poor and/or unrealistic assumptions that may result in misleading conclusions:
  - The Energy Efficiency for Houses RIS assumed that the benefits and costs of energy efficiency measures in existing houses with alterations were 'broadly the same' as for new houses.[12]
  - The Energy Efficiency for Houses RIS assumed that banks would increase their loans to a customer just because a building is energy efficient.[13]

11 'Draft RIS: Proposal to amend the Building Code of Australia to increase the energy efficiency requirements for houses', April 2005, p.5.

12 Ibid. , p.34.

13 Ibid., pp. 41.

- Lack of consideration of policy alternatives: The consideration of other forms of regulation or non-regulatory options in the Energy Efficiency for Buildings RIS was cursory at best, and many solutions to encouraging energy efficiency were ignored in preference for regulatory approaches. [14]

- Biased formulation of costs and benefits: The Energy Efficiency for Buildings RIS ignored the implications of its proposed changes for existing buildings even though these make up 98% of Australia's building stock per annum, and are arguably the area of the greatest costs.

In addition, the Property Council has noted the lack of standardisation and consistency in the presentation of costs and benefits in RISs across government departments.[15]

14 'Draft RIS: Proposal to Amend the Building Code of Australia to include Energy Efficiency Requirements for Class 5 to 9 Buildings', March 2005.

15 This issue is explored at greater length in Section 3.

3. OPTIONS FOR IMPROVING THE EFFECTIVENESS OF THE RIS

In this section I develop a range of options to address the weaknesses in the application of the RIS identified above by drawing on the experiences of other jurisdictions, including those of particular Australian States and Territories. The earlier discussion noted two main problems with the current RIS framework – a lack of integration of RISs into decision making processes and the poor quality of analysis in RISs.

These problems are interrelated. Measures to make an RIS a more genuine decision making tool would have the automatic effect of improving the quality of the RIS produced. This is because insofar as RISs are poorly integrated into the decision making process, there are also limited incentives to produce high quality RISs, which exceed the (low) minimum standards required for compliance.

This section therefore focuses on options for:

- Reforming the RIS process to make RIS a more genuine decision-making tool; and
- Improving the average quality of RISs.

I also discuss transparency and training issues that impact on RIS compliance and public reporting. The recommendations developed here are intended to serve as a template for further improvements at all levels of government in Australia.

3.1. BETTER INTEGRATION OF RISS INTO THE DECISION-MAKING PROCESS

Current standards applied to RISs encourage a lowest common denominator approach to compliance:

- Currently the main disincentive for not complying with the RIS requirements is through a form of ‘public shaming’; and
- Furthermore, there is no scope for differentiating the quality of RISs beyond the already low standards for adequacy and for further publicising these differences in quality attained by different departments and regulatory agencies.

Related to the above, community consultation is not required for Commonwealth RISs, with the exception of RISs applying to Ministerial Councils and national standard setting bodies where a draft RIS should be made available to the public as part of the community consultation process. Indeed, the Commonwealth generally places a lower priority on consultation than other jurisdictions. The ORR in its *Guide to Regulation* encourages departments and agencies to prepare and release a draft RIS for public consultation, but there is no formal requirement to do so. Even in the *Guide* the ORR states that "*Where consultation is not possible before regulation is made, consultation should occur afterwards*."[16]

Below I consider in more detail how other jurisdictions have tried to better integrate RIS into decision-making by in effect raising the political and institutional stakes for regulators to not just comply with RIS requirement, but to produce RISs with substantive analytical content.

3.1.1. Approaches in other jurisdictions

Putting more teeth on regulation review bodies

A number of overseas jurisdictions and one in Australia have more 'teeth' on their regulatory review bodies than the Commonwealth ORR currently does.

In the **ACT**, Draft Cabinet submissions do not receive Treasury endorsement if their associated RIS fails scrutiny in terms of analysis or content. Departments/agencies are required to address Treasury concerns prior to final submissions going to Cabinet for a decision on what regulations to implement. The Cabinet Office in the Chief Minister's Department may reject submissions for not meeting the required standard.

In **Denmark**, the Ministry of Finance performs the role of quality control of RISs. The Ministry must scrutinise the RISs produced by regulators and confirm the expected consequences on the public sector, before any bill can be presented to the Parliament. The Ministry of Economic and Business Affairs, and the Ministry of Environment are consulted with respect to their areas of responsibility.

In **Canada**, the Regulatory Affairs and Orders in Council Secretariat (RAOICS) of the Privy Council has the power to refuse to allow a proposal to go to Cabinet on the basis of inadequate analysis. The Special Committee of Council needs a completed RIA and written confidential comments on the RIA provided by RAOICS before considering and deciding on the proposals that Ministers submit to the Governor in Council for approval.

In the **United States**, the Office for Information and Regulatory Policy (OIRA) has the power to return regulatory proposals to agencies for reconsideration if there are significant concerns about the proposal or if it is not supported by adequate impact analysis.

16 Office of Regulation Review 1998, 'A guide to regulation', p. A5.

By far the strongest sanctions for non-compliance with RIS requirements can be found in **Mexico**. Officials from sponsoring agencies of regulations can be strongly penalised, including by removal from their post for up to one year, for repeated violations of regulatory reform and transparency requirements.

Consultation and ministerial sign-off requirements

While consultation may be time-consuming and hence costly, it is nonetheless an effective mechanism for drawing out the range of possible costs and benefits from a proposed regulation.

In **Tasmania**, consultation is mandatory for both primary and subordinate legislation where an RIS is considered necessary. Advertisements need to be placed in relevant local newspapers or other publications inviting submissions on the RIS after the RIS and overall public consultation program is approved by the State's Competition policy unit. A minimum of 21 days must be allowed for receipt of submissions. Particular interest groups are usually directly provided with a copy of the RIS.

In **New Zealand**, the consultation process is facilitated through a government website (www.businessconsultation.govt.nz) which provides the opportunity for interested parties to participate in consultation on particular issues; and automatically notifies interested parties of relevant public consultation processes.

In the **UK**, consultation is mandatory for all regulatory proposals that require an RIS, with a minimum consultation period of twelve weeks. A partial RIS[17] to guide the collective decision-making of Ministers is required, followed by a more expanded RIS during the period of formal public consultations. In January 2004 the consultation requirement was further strengthened in the form of a revised code of practice formulated by the UK Cabinet Office that applies to public consultations by all government departments and agencies, including consultations on European Union (EU) directives. The code consists of six main principles that public consultations must follow, namely to:

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;

2. Be clear about the nature of the proposals, who may be affected, the questions being asked, and the time scale for responses;

3. Ensure that consultation is clear, concise and widely accessible;

4. Provide feedback regarding the responses that were received and how the consultation process influenced the policy;

17 This refers to a RIS of short length which discusses the principle behind the regulation in the particular area in question.

5. Monitor the respective department's effectiveness at consultation, including through the use of a designated consultation coordinator; and

6. Ensure that consultation follows regulation best practice, including carrying out a RIS if appropriate.

In **Canada**, an RIS must be published for a 30-day period in the Canada Gazette, Part I, along with the proposed regulation to elicit comments from the public. When required by legislation or international trade agreements, this period is extended.

Also pertinent here are measures which would require a high level official to be accountable for the quality of the RIS. This would be expected to improve the direct accountability for RIS quality and compliance.

Under the **Victorian** *Subordinate Legislation Act 1994*, the responsible Minister must, before a decision is made with respect to approving a regulation, provide a compliance certificate in writing specifying that:

- The requirements relating to the RIS have been complied with; and
- In the opinion of the Minister, the RIS adequately assesses the likely impact of the proposed rule.

The certificate is signed by the Minister when the RIS process is complete. A copy of the certificate must be submitted to the Scrutiny of Acts and Regulations Committee as soon as practicable after the statutory rule resulting from the approved regulation is made.

As part of this certification process, the responsible minister must also ensure that independent advice is sought to confirm the adequacy of an RIS – either from a consultant, the Victorian Office of Regulation Reform or other units within Government.

The **UK** approach requires RISs to be included as part of ministerial correspondence seeking collective agreement for 'significant proposals'. The Minister must then confirm that the benefits of the regulation exceed the costs.

In **Mexico**, formal requirements for Ministerial signoffs have also been legislated. RISs for proposed laws, presidential regulations and decrees must be signed off by high-level officials such as the Deputy Minister, and for other subordinate regulations by general directors, before being sent to the Economic Deregulation Unit (UDE).

3.1.2. Options for reform

My survey of best practices in other jurisdictions points to a number of reform options for better integrating RIS into decision-making processes.

Ministerial signoff and mandatory consultation

A stronger requirement for consultation could potentially lead to better integration into regulatory decision making for RISs, as would requiring Ministerial (or high-level) signoff on the adequacy of RISs. Consultation is relatively underused in policymaking at present. A recent government survey found that only 25% of regulatory agencies have engaged in consultations with the public when developing regulations.[18]

Consultation requirements can indirectly contribute to higher quality RISs and decision making in general because, as the Regulation Taskforce has noted, engaging in consultation provides regulators with access to information that might otherwise not be available, particularly about the likely compliance costs of different options, therefore reducing the risk of unintended consequences.[19] In addition there are additional benefits from consultation in the sense of conferring a greater sense of ownership to the regulated parties in the process, which may translate into higher rates of compliance with the regulation in question. Thus there are clear gains to all parties from stricter consultation procedures being followed before a regulation is 'cleared', although there are also some additional costs associated with a possibly slower regulation-making process and higher administrative costs during the making of the regulation.

One reform option would be to adopt an approach similar to the Tasmanian requirement for mandatory consultation and the Victorian requirement for Ministerial sign-off. This would involve:

- Legislating as a requirement for the RIS process that a minimum period of time be provided for public consultations on RISs covering significant or complex regulatory issues. 'Significant' or 'complex' could continue to be determined on the basis of an evaluation by the ORR; or[20]

- Legislating to require in the case of all Commonwealth RISs, that the relevant Minister should certify that the RIS process has been followed and that the RIS adequately assesses the impact of the proposed rule. This requirement would signal to regulators and relevant Ministers the high priority of the RIS process and thereby heighten the political stakes for non-compliance.

These measures, especially the first one, would be expected to at least encourage the preparation of an RIS earlier in the policy development process. The Regulation Taskforce, in its final report, highlighted the importance of undertaking consultations early on in the process because it is at that stage that different approaches to an issue can still be considered.

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18 Australian Public Service Commission 2005, *State of the service 2004-2005,* p. 56.

19 Regulation Taskforce 2006, *Rethinking regulation,* Report to the Prime Minister and the Treasurer, Canberra, p. 150.

20 However see the section on threshold tests for possibilities for tightening this definition up.

Finally it is worth noting that the cultivation of a 'consultation culture' among regulators should be seen as part and parcel of the cultivation of a culture among regulators that sees RIS as a genuine decision-making tool. Indeed the process of consultation is integral to the information gathering that would occur under an effective RIS process.

A requirement for Ministerial signoff may also deliver benefits to the integration of RIS processes in decision-making by signalling their importance. While such an approach may seem more symbolic than resulting in specific practical measures, there is at least one powerful example of where Ministerial signoff has changed the corporate culture of a government department for the better. Many submissions to the Regulation Taskforce have noted the strong disciplines on budgetary spending proposals that seemed to be induced by a requirement for Ministerial signoff on the Expenditure Review Committee. This is frequently contrasted with the lack of attention given to the evaluation of costs and benefits of regulations. As the Taskforce has noted, the lesson from this experience seems to be that:[21]

> *If ministers and senior officials are seen as placing importance on the costs of regulation, and on good process generally, this will cascade down to those developing regulations.*

Nonetheless the discussion so far should not be interpreted to mean that these measures alone would be sufficient for improving the effectiveness of the RIS process. Ultimately, it would be easy to comply with the letter of such measures, including consultation, without complying with the spirit. Furthermore, based on the Property Council's practical experience, little is accomplished if consultation in particular is merely viewed to be a formality, rather than a forum in which substantive discussions may take place. Indeed, one member of the Property Council, the Shopping Centre Council, has found regular reviews in its industry sector to be counterproductive insofar as they have created opportunities to add to the stock of regulation rather than assessing ways of making regulation more cost effective.[22]

In conclusion, measures such as those of requiring Ministerial sign-off and mandating consultation requirements to cover all Commonwealth RISs would at best be necessary but not sufficient measures for enhancing the use of the RIS as a decision-making tool absent more substantive reforms that focus on increasing the powers of the ORR.

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21 Regulation Taskforce 2006, *Rethinking regulation,* Report to the Prime Minister and the Treasurer, Canberra, p. 156.

22 For instance, the Shopping Centre Council of Australia notes that while it has only been in existence for seven years, during that time it has participated in ten retail tenancy reviews, and that each review has led to more regulation. It also cites the case of Victoria where the Retail Tenancies Act in 1987 had 26 clauses. The next major overhaul of the legislation, led to the Retail Tenancies Reform Act in 1998 with 52 clauses. The new Retail Leases Act which began in 2003, has 123 clauses. These constituted almost a five-fold increase in regulation in less than 20 years.

Secondment of ORR staff to regulators' offices

In many respects, current problems with the RIS compliance reflect the fact that compliance has focused on the letter, rather than the spirit of the law. It is difficult to deal with such issues as it would involve changing the corporate culture of regulatory agencies and government departments. That is, it would involve a systematic change in the attitudes and habits of mind of staff in government departments who may be still used to the old ways of assessing regulation and are still unfamiliar with the idea of thinking through the 'second order' impacts of regulation. One minor example of how these intellectual habits continue to be significant is that, as noted in Section 2, most RISs which are produced still continue to misunderstand the idea of economic costs and instead evaluate the costs of a regulation solely in terms of whatever levies are associated with it. While it may be possible to change the corporate culture of a regulatory agency in the long run, more immediate changes may be needed to improve the incentives for improved integration of RIS processes.

One way of giving effect to a faster change in corporate culture is to encourage greater permeability between the ORR and government agencies. This could be achieved by seconding ORR staff to regulators' offices (and vice versa), with the aim of achieving a greater level of involvement in the preparation of the draft and final RISs for proposed regulations. Such secondments could also be targeted towards specific departments where compliance is perceived to be poor.

Giving the ORR more direct veto powers

To strengthen the quality control function of the ORR, Australia could draw on the legislation currently in place in those jurisdictions surveyed, which give a veto power to their regulatory review bodies, such as the US and Canada. The aim would be to expand the powers of the ORR, giving it a direct power of veto over any significant regulation judged to have an inadequate RIS.

If such a measure were to be adopted, it would need to be accompanied by greater funding for the ORR, commensurate with its expanded powers and responsibilities. This would ensure it had appropriate capabilities in vetting regulation, given the significant consequences its actions would have for the passage of legislation. As the Regulation Taskforce has noted, such a move would entail a corresponding trade-off, in terms of costs:[23]

23 Regulation Taskforce 2006, *Rethinking regulation,* Report to the Prime Minister and the Treasurer, Canberra, p.157.

> *While the evidence before the Taskforce on the causes and effects of excessive and poor quality regulation indicates that better regulation-making processes would generate substantial benefits over the longer term, higher standard analysis and more effective consultation processes will come at some additional administrative cost to government. Recent ORR data suggests that, for many proposals, the average costs of RISs to date have not been high. However, this may not be a good guide to what might be needed to follow best practice — for example, when policy options (green) papers for regulatory proposals of major significance are released.*
>
> *Even so, the additional costs to government are likely to be small compared to the compliance costs to business of many regulations — or to the costs to government of fixing bad regulations. In this context, a somewhat higher administrative cost for government in establishing regulation needs to be balanced by the potential for ongoing administrative savings, to business and government alike, of well designed regulation …*
>
> *In the Taskforce's view, the additional costs to government of good process should not be used as an excuse for ongoing under-performance. Rather, proper analysis of regulations before they are implemented should be seen as a core requirement — not an optional extra. Accordingly, the onus should be on government to make the case for any regulatory action it takes, and allocate the necessary resources.*

As the Taskforce correctly notes, the additional and likely substantial upfront costs of instituting stricter RIS processes, does not mean that the investment in reform should not be made. I concur with the Taskforce's judgment that, given evidence of widespread failures of regulatory processes, the long run benefits of an improved RIS process in reducing the incidence of regulatory failures are likely to outweigh additional costs from increased ORR funding.

Reconsider current exemptions from RIS requirements

Another aspect of the current Australian RIS framework that may merit review relates to those bodies which are exempt from RIS requirements. Currently there are exemptions from RIS requirements for local government decisions and planning regulations.

There is a reasonable case for exemptions from local government regulations; adding another tier of regulation, which needs RIS review, would increase the burden on the ORR and therefore a potentially significant increase in funding requirements. At the same time, a RIS requirement would slow down the process of regulation at the local government level, and delays in decision-making at local government level could add to uncertainty for regulated parties.

These drawbacks must be balanced against the increased likelihood of better regulatory decisions being made as noted in the arguments advanced above.

The importance of local government in contributing to regulatory overload is underrated, according to the experience of the Property Council. In my discussions with the Council, the Council notes in particular the recently increased zeal of local governments in passing poorly conceived legislation in the area of sustainability policy, which is sometimes even outside its jurisdiction. The problem is that local councils are frequently oblivious to the wider repercussions of their regulations, as they are not well resourced enough to perform better evaluation of their regulations and yet have the power to make potentially high impact regulations.

It may therefore be appropriate to remove the current exemption from undertaking a RIS on local government regulations, at least for regulatory proposals where the costs of the regulation are likely to exceed a minimum level. As would be the case for the proposal for regulatory veto powers, this reform may have to be accompanied by increased funding, if the ORR's monitoring role is strengthened, and for relevant councils to undertake the required analysis.

An accompanying measure would be to remove the current exemption on planning regulations. At a minimum, planning regulations at a state level could be required to undergo an RIS process, in order to enable an improved assessment of the costs and benefits of proposed regulation. This would be an improvement on the current situation, even if the local government RIS exemption remains, because the property sector in particular is burdened with planning regulations at a local government, as well as a state level.

3.1.3. Recommendations

I recommend that the following measures to better integrate RIS into the regulatory decision-making process be further explored and developed:

- Mandatory consultation with a minimum consultation period for all proposed regulations above a minimum materiality threshold and differentiated according to the significance of the regulation in terms of its likely cost consequences, and requiring the publication of a draft RIS at the start of the consultation period;
- A requirement on the relevant Minister to certify that the RIS process has been followed, and that the RIS adequately assesses the impact of the proposed rule;
- The regular secondment of ORR staff to government departments to enable an improved ‘culture of compliance’;
- The right by the ORR to veto significant regulations judged to have been inadequately assessed under an RIS; and
- The removal of local government and planning legislation exemptions from RIS requirements, at least above a certain materiality threshold.

3.2. IMPROVING THE QUALITY OF RISS

The discussion in Section 2 highlighted the generally low standards of analysis and quantifications in the sample of RISs that I analysed. The Property Council also identified low standards of analysis in the RISs it has encountered in the course of dealing with regulators whereby RISs were characterised by the selective use of data, unrealistic assumptions and flawed methodologies. The Council also notes occasional evidence of bad faith in the preparation of RISs by regulator's consultants.

The purpose of this section is to discuss proposals that could better address the currently low average quality of RISs, at least as perceived by regulated parties. The measures discussed here should be interpreted as complementary to those aimed at better integrating RISs into the decision-making process: the resulting benefits are likely to flow in both directions.

First, as noted, the poor quality of RISs can partly be attributed to the low stakes placed on producing a good RIS at present. This has tended to lead to a minimalist approach by regulators in complying with RIS requirements. Second, better quality RISs are likely to naturally lead to a better integration of the RIS into the decision-making process, if this leads to a better appreciation of the value of a robust framework for describing the objectives, effects and implementation of regulations.

Below I set out three broad approaches that have been adopted in other jurisdictions in order to improve the average quality of RISs:

- The widespread use of higher quality, independently verifiable data to quantify costs and benefits;
- Better and more widespread use of rigorous analytical methods; and
- The review of past RISs and a comparison with actual outcomes to improve accountability and aid the learning process of regulators.

3.2.1. Better measurement and assessment of regulatory costs – The approaches of other jurisdictions

Internationally, a number of jurisdictions have put in place formalised frameworks to assess the costs of new regulations.

In **Denmark** Business Panels are used to involve enterprises in the assessment of the administrative consequences of new legislation and ministerial acts in three ways:

- Test Panels consisting of 500 enterprises each that broadly represent the Danish business community assess new regulations that will affect all types of enterprises;
- Focus Panels, typically consisting of 100 enterprises, are assembled for industry-specific legislation or specific types of enterprises; and

- Test Groups consisting of a small number of affected enterprises, the promulgating authority and possible experts assess very specific proposals. Unlike the other two methods, a Test Group takes part in a meeting at which proposals for new legislation are discussed.

While the emphasis in these Panels is as much on qualitative assessments of proposed regulations, there may also be scope for collection of more industry specific quantitative data for the purpose of better measuring compliance costs using these Panels.

The **Netherlands** have adopted improved processes for assessing compliance costs under which each government department uses a 'Standard Cost Model' (SCM) to measure administrative burdens so that these can be monitored and progressively reduced. The SCM measures the administrative burden associated with each regulatory obligation in terms of euros per year. The Dutch Minister of Finance is responsible for reduction targets. Under the SCM, the administrative burden is defined as the cost imposed on business when complying with information obligations stemming from government regulation.[24]

In **Australia**, the Office of Small Business has recently developed an interactive costing tool to better measure the compliance costs of regulation. This tool is based on the Netherlands approach outlined above. The tool enables users to systematically estimate the cost of various activities or tasks a business is required to undertake to comply with a particular regulation. It categorises possible costs such as costs of 'notification', 'education', 'record-keeping' and others.

3.2.2. Better use of analytical techniques in RISs – The approaches of other jurisdictions

The ORR's *Guide to Regulation* already sets out a comprehensive methodology for producing an RIS. The Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies, endorsed by the Council of Australian Governments (COAG), also extensively discusses the strengths and weaknesses of different analytical methods, including cost benefit analysis (CBA) and cost effectiveness analysis (CEA).[25] However there are a number of possible refinements and additions to increase the quality of RISs.

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24 Specifically the regulatory burden associated with a regulatory obligation is estimated using the formula N x W x T where N is the number of businesses affected by the obligation, W is the hourly wage of business employees which have to meet the obligation, and T is the number of hours taken to meet the obligation a year.

25 A cost-benefit analysis compares the respective costs and benefits to society – including businesses and consumers – of pursuing alternative courses of action, for instance proceeding or not proceeding with a regulation, over a specific time horizon. The 'best' option under a cost-benefit analysis is the one that delivers the greatest net benefit, in terms of benefits minus costs.

In contrast, a cost-effectiveness analysis assumes that the benefits of alternative options being considered are identical and only seeks to identify the least-cost option.

The agency responsible for the United States' regulatory impact analysis processes, the Office of Information and Regulatory Affairs, located within the Office of Management and Budget, has issued new guidelines for the conduct of regulatory analysis by government agencies that are relevant in this context. These guidelines reflect the greater data and analytical requirements associated with undertaking a CBA as opposed to a CEA. A CEA is used instead of a CBA either where it is difficult to quantify the benefits of different regulatory options in dollar value terms or where it is unnecessary to do so because each option can be assumed to have the same monetary benefits. Under these circumstances, a CEA is a technique that can be used to compare the costs of different options with the same or similar outputs or benefits where these outputs or benefits are quantified in physical units rather than monetary terms (e.g. lives saved). CEA therefore allows for a priority ranking of proposals on the basis of comparative 'cost per unit of effectiveness'.

The guidelines also refer to other ways of improving the quality of analysis in RISs. Thus, if the effects of a regulation cannot be quantified or expressed in monetary terms, an explanation of why this is the case and the presentation of all available quantitative information along with the timing and likelihood of the effect would be required. Alternatively, 'willingness-to-pay' measures should be applied if costs and benefits are not conventionally traded.

The **UK** guidelines for RISs also encourage other forms of quantification suitable for undertaking a CEA, for instance, in terms of numbers of lives saved, increased manpower requirements, or changes in emission levels. Such measures allow options to be compared in terms of costs, even if they do not permit a comprehensive assessment of relative costs and benefits.

Another means of better use of cost-benefit analysis and other appropriate analytical techniques is by better targeting analyses to more substantive proposed regulations. Several OECD countries use monetary thresholds as a 'rule of thumb' for determining significance (e.g. Korea and the US), usually in conjunction with other criteria.

In the **US**, full cost-benefit analysis of regulatory proposals is needed where annual costs are estimated to exceed US$100 million, where rules are likely to impose major increases in costs for a specific sector or region, or where they may have significant adverse effects on competition, employment, investment, productivity or innovation.

In the **United Kingdom**, the criteria for judging whether a proposal requires a full RIA include:

- Significant costs (for instance, costs in any year in excess of £20 million);
- High topicality or sensitivity; or
- A disproportionate impact on a particular group (for example, small business).

In **Canada**, all significant regulatory proposals must undergo a cost/benefit analysis. A significant regulation is defined as one with a present value of cost greater than $50 million, or if it has a lower present value of costs and a low degree of public acceptance. In addition, the Canadian government has also identified the following categories of low-cost regulations as examples of regulations which would likely *not* require more detailed cost benefit analysis:

- Repetitive regulations: those that are replicated in essentially the same form on a regular basis (e.g., regulations naming members to boards of various agencies);
- Minor regulations: those that have no policy implications (e.g., minor amendments to existing regulations); and
- Minor types of external user fee regulations (e.g., small amendments to existing fee schedules).

In 2002, the **European Commission** adopted the *Simplifying and improving the regulatory environment* action plan which included a two stage approach to impact assessment.[26] This involves a preliminary assessment prepared for all major policy proposals; and, on the basis of this assessment, the Commission determines which proposals require an extended impact analysis.

3.2.3. Ex post monitoring – The approaches of other jurisdictions

A number of international jurisdictions complement ex ante processes with ex post reviews to assess the impact of regulations.

In **Denmark,** the government annually chooses approximately 15 new laws that must be reviewed three years after their introduction. However the review does not require a strict use of RISs for this monitoring.

The **European Union** also adopted an ex post monitoring program for regulations in the 1990s. In particular, new legislative proposals are required to consider review clauses, where appropriate, in particular in areas subject to rapid technological change. Since 2002 there has also been a program to update and simplify community legislation.

Germany has in a place a system of 'retrospective' RIS review. The retrospective RIS is produced when operational experience is available after implementation of a regulation. In producing a retrospective RIA, the agency in question is required to follow up on whether the regulatory objectives have been achieved and whether the regulation should be revised.

26 Communication from the European Commission, 'Action plan: Simplifying and improving the regulatory environment', available at http://europa.eu/eur-lex/en/com/cnc/2002/com2002_0278en01.pdf

3.2.4. Options for reform

In this subsection I assess the likely effectiveness of reform options to improve the average quality of RISs.

Greater standardisation and consistency of RIS format

As noted previously, and notwithstanding the requirement for consistency in the steps prescribed for prescribing an RIS in the ORR's *Guide to Regulation*, the presentation of costs and benefits, as well as of quantitative results is frequently not consistent across departments. For instance, a minimum requirement could relate to the inclusion of a table of results in every RIS summarising the costs and benefits that have been quantified. Thus even relatively minor formal requirements of RISs may significantly enhance the transparency of RISs to stakeholders.

A measure increasing the format consistency requirements of RISs would be relatively low-cost to implement while the long term benefits could be substantial. Making these RISs more accessible to scrutiny would tend to increase incentives to improve the quality of RISs in addition to the minor quality improvement mandated by such a requirement.

Improved transparency of data and analysis undertaken

In the Property Council's experience, it can be difficult to check the costs and benefit quantifications made by some RISs because the calculations and relevant assumptions are not provided transparently or in any systematic manner. A formal requirement to present any underlying data assumptions and the analysis undertaken would significantly aid the public scrutiny of RISs.

Better measurement of compliance costs and administrative burdens

While limitations are likely to remain in practice, various measures are available for improving the quality of the data used.

In many instances, regulatory costs (and benefits) can only be evaluated on a case by case basis. The nature and magnitude of such costs depend on the circumstances in question, highlighting the importance of a rigorous framework within which an analysis of costs and benefits should be undertaken.

The direct costs of regulation may, however, be more amenable to a standardised framework for analysis. While it only measures the administrative and compliance costs associated with regulations, the costing tool developed by the Office of Small Business provides a verifiable indication of the size of the compliance burden. Such an approach would also be complemented by the use of business panels, such as those adopted in Denmark to assist in the data collection process, as well as in developing more industry specific qualitative assessments of administrative burdens. The aim of both these proposals would be to:

- Require consistency in the documentation and measurement of the costs of regulation that would likely be imposed on regulated parties; and

- Gradually establish a reliable and verifiable database that would also provide guidance to future regulatory proposals.

Better use of cost-benefit analysis and other analytical methodologies

My earlier discussion set out various approaches for assessing the benefits to society of a proposed regulation. The analysis of the RIS in section 2.2.2 showed that currently few RISs attempt to rigorously quantify the impact – in terms of its overall costs and benefits to society – of regulations.

I propose that the current RIS content guidelines should be modified to require the adoption of the most rigorous analytical and quantitative techniques that are feasible given the information that is available to the decision maker. This means that decision-makers should ideally have to undertaken a quantified cost-benefit analysis (CBA) to justify their regulations, and if information is insufficient to do this, perform a cost effectiveness analysis as a 'second best' alternative. Failing that, decision-makers should still attempt to quantify as much of the benefits and costs as possible (though this does not have to be restricted to monetary quantification). The choice of methodology employed could be linked to the significance of the regulation, and would need to be justified in the course of the RIS according to a discussion of the information and opportunities available to the decision-maker.

Because I regard systematic quantification of costs and benefits via a CBA as the 'first best' approach that all RISs should adopt, below I discuss in greater detail the strengths and weakness of CBA and systematic quantification in order to justify my proposal.

The central principle underpinning CBA is that proposed regulations should be evaluated to assess whether the gains they bring exceed the costs imposed. Where the gains associated with a proposed regulation exceed its costs, the presumption is that those who secure these gains could potentially compensate those who bear the costs, leaving the 'winners' better off from the policy change without the 'losers' necessarily being any worse off. As a result, the proposed policy would, at least potentially, increase community income and well-being.[27]

The rationale behind CBA is no more than a restatement of the principle, known as the axiom of rational choice, namely that courses of conduct should be chosen in the light of their consequences. That said, the analysis almost always involves the expression of costs and benefits in monetary terms.

27 In reality, compensation is frequently not paid to compensate the losers from a regulation. But the point is that at if compensation could potentially be paid while still leaving some benefits 'on the table', then this strongly suggests that the regulation leads to a net improvement for the community.

While monetisation of costs and benefits raises complex theoretical issues,[28] it is fundamental to quantification of the effects of regulation. Furthermore, the most obvious problems monetisation poses for the use of CBA arise when policy choices revolve around 'fundamental values', rather than on a balance of consequences. However, questions of fundamental values almost rarely crop up in regulatory decision-making, where the general policy objectives behind a regulation are accepted by all parties and the real question hinges on how these objectives are best achieved.

Monetary valuations for the assessment of the costs and benefits of a regulation under a CBA approach will generally be derived by reference to the value individual members of the community would place on that regulation's effects. In practice this means that when regulations affect traded goods and services, those valuations will be made by looking at how market prices of goods and services are affected by the regulation since such prices reflect individuals' willingness to pay for benefits and willingness to accept for costs.[29] Where the effects involve goods and services such as pollution, that are not traded (so that there are not market prices that reflect valuations), or the non-traded dimensions of goods and services (such as consumption or production externalities associated with the supply of goods and services affected by the policy[30]), then valuations need to be imputed by means such as contingent valuation surveys[31] or hedonic price estimation.[32]

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28 These arise from the fact that the conceptual bases for cost-benefit analysis in welfare economics are based on analysis in terms of utility, or more generally, welfare, rather than in monetary terms.

29 There is strong evidence that individuals' willingness to pay to obtain a benefit and willingness to accept to give up that benefit are not symmetric. More specifically, individuals seem to display a degree of loss aversion, whereby additional marginal benefits are valued less highly than the retention of existing benefits at the margin. This can create difficulties for cost-benefit analysis, and is the subject of a lively methodological debate among economists involved in this area.

30 Externalities are effects that are not mediated through the price system – that is, they are consequences of an economic action that do not enter directly into the assessment, by the agent deciding to undertake that action, of the action's costs and benefits. Because these consequences are not factored into the decision, the agent's decisions may not be optimal in terms of their overall impacts. As a result, decentralised decision-making may lead to market failure. An example of an externality that may be relevant to an authorisation application would be a situation where authorising the proposed conduct would increase the price of a good (say, cigarettes) whose consumption involves negative externalities (i.e. costs that are not borne as a result of a voluntary market transaction – in this case, the harm from passive smoking that affects parties that play no role in determining the smoker's decision to smoke). The reduction in these negative externalities as consumption of cigarettes falls is a benefit of the conduct, which would be quantified in a cost-benefit analysis.

31 Contingent valuation surveys are surveys in which respondents' willingness to pay for particular effects are elicited. For example, respondents may be asked how much they would be willing to pay for the preservation of old-growth forests or of wet-lands. An issue with respect to these surveys is that stated willingness to pay is often implausibly large.

32 Hedonic price methods involve deriving valuations for non-traded effects by inference from observed prices for traded goods and services. For example, workers' valuations of risk can be inferred to some degree from wage differentials between more and less risky occupations. Equally, consumers' valuations of an untrammelled view can to some degree be inferred from prices for houses with such views relative to prices for houses without such views.

The benefits of greater use of quantified CBAs in RISs can be classified into two broad types.

The first are the intrinsic benefits of using a decision rule that seems sensible in terms of what was referred to earlier as the axiom of rational choice i.e. the principle that courses of conduct should be chosen in the light of their consequences. Application of this principle is consistent with a CBA approach to regulatory decision-making whereby the means of attaining the policy objectives (i.e. the specific regulation) is chosen on the basis of

(i) Whether the gains outweigh the costs of the regulation and

(ii) If so, by how much (the specific regulation being chosen therefore having the highest net benefit).

Adopting such a practice would seem likely to lead to better decisions than would occur when the decision criterion is less carefully specified.

The second set of advantages goes more broadly to the effect that greater reliance on systematic quantification would have on the quality of the regulatory decision-making process. Here five main areas of impact can be distinguished.

Firstly, greater quantification of benefits would make the basis on which decisions were being taken more **transparent**. This is because all the critical elements in the decision would be identified (e.g. the RIS would demonstrate not only that for a particular regulation, the benefits exceeded the costs, but also what the predominant benefits were).

Secondly and closely associated with greater transparency would be increased pressure for **consistency**. If for instance, a regulator decided to use a specific methodology to quantify the benefit of one regulation, it would be under pressure to apply the same methodology to a similar regulation in future and would have to give good reasons for inconsistent treatment.

Thirdly, greater transparency would also yield benefits in terms of increased **accountability**. This is because third parties would be able to better examine whether the estimates involved in quantified RISs were reasonable, both in the circumstances of the time and in the light of eventual outcomes. Additionally, systematic quantification would facilitate review of regulatory decisions as it would allow the parties to concentrate on the estimates used in the assessment of costs and benefits and on the methodologies employed.

Fourthly, systematic quantification would make the regulatory decision-making process more **cost-effective** over the long term. This is because firstly it would provide government departments with a clear framework for preparing RISs, especially if there is a detailed guide to the manner in which quantification should be carried out. Additionally, it would allow the ORR to improve its assessment of RISs. Finally, after a period of time, an element of routine, or at least predictable methodology, would be introduced into the regulatory decision-making process, allowing for the more efficient use of resources in the course of that process.

Finally, systematic quantification would enhance the **legitimacy** of regulatory decisions. Understanding the basis on which decisions have been taken would make it more likely that regulated parties and the wider community could recognise the authoritative nature of the decision taken by the regulatory agency or government department. By demonstrating that its decisions were based on careful, transparent and testable assessments of costs and benefits, the decision-maker would more effectively address concerns about its decisional processes.

On the other hand, the limitations and costs of greater reliance on systematic quantification also need to be acknowledged. However, these costs over the longer term are not especially high when compared to the ongoing benefits of greater reliance on systematic quantification identified above.

The resource costs of quantifying the impact of proposed regulations would not be especially high over the long term once the learning process of government departments and regulatory agencies new to such methods has been well established. This is all the more so as there is so much experience with conducting such studies in other areas of public decision-making. Nonetheless, some initial investment of additional resources into the ORR and complying government departments would be required to account for the greater substance of RIS related material that would need to be produced and assessed.

As with any other decision-making method, it could be argued that placing greater weight on systematic cost-benefit analysis could displace efforts by regulators and other interested parties from other forms of persuasion to investment in the quantification process. Thus, effort that previously went into essentially qualitative arguments would simply go into ‘fudging’ quantitative assessments. However, whether such substitution would be so significant as to hinder any net improvement in decision-making is open to doubt. Of course, all quantification of the kind at issue here is open to debate and hence offers some scope for ‘fudging.’ Nonetheless, exposing estimates to testing imposes a substantial discipline, and it is difficult to believe that such testing would not lead to improved application of the methodology over time.

What studies there are of the impact of reliance on cost-benefit analysis on the quality of the policy process suggests that though economically inefficient decisions continue to be made, there are reasons to believe that fewer very poor decisions are taken.[33] Additionally, and importantly, CBAs have allowed poor decisions to be identified, stimulating efforts to secure greater emphasis on efficiency in the agencies concerned. [34] As a result, the record seems consistent with reliance on cost-benefit analysis making some contribution to the quality of the policy process.

Additionally, it might be argued that reliance on systematic quantification could lead to the overlooking or undervaluation of 'intangible' or ultimately non-commensurable effects of regulation. However, this implies a more mechanical approach to quantification than what I have proposed. Rather, where genuinely 'intangible' or non-commensurable effects are relevant, it is obvious that they should be taken into account in the ultimate assessment.

In conclusion, the arguments against relying on systematic quantification of costs and benefits of authorisation decisions seem weak in their substance, their relevance or both, particularly when a longer-term perspective is taken. On the other hand, the gains from CBA, in terms of improved decision-making processes, seem significant. Therefore I believe that the RIS framework would be significantly improved by requiring quantified CBAs in all RIS at least as a 'first best' preference so that reasons would have to be given to justify the failure to produce a CBA.

33 See for example, Coglianese, Cary 2002, "Empirical analysis and administrative law", mimeo, John F Kennedy School of Government, Harvard University, at page 16.

34 For example, there is evidence that decisions taken by different US government agencies imply very different valuations of the cost of saving lives – see Tengs, Tammy and John D. Graham 1996, "The opportunity costs of haphazard social investments in life saving" in Robert W. Hahn *Risks, Costs, and Lives Saved: Getting Better Results from Regulation* at 167, 177. This has naturally focussed attention on the scope for improving outcomes by shifting outlays from less cost-effective to more cost-effective life saving programs.

More recent evidence is available from OECD reviews. In the Netherlands, 20 per cent of regulatory proposals were modified or retracted as a result of RIA conducted as part of a targeted review program. (OECD 2002, OECD Review of Regulatory Reform: Regulatory Policies in OECD Countries; From Interventionism to Regulatory Governance, p. 48). Some 60 per cent of US regulations are changed during review by the Office of Management and Budget (OECD 1999, Regulatory Reform in the United States of America, p. 153). Gains in terms of higher productivity and wealth creation are particularly evident in countries such as Canada, the US, and the UK with longstanding regulatory policies (OECD 2002, OECD Review of Regulatory Reform: Regulatory Policies in OECD Countries; From Interventionism to Regulatory Governance, p. 40).

Ex-post audits of RISs

The best developed system of ex post audits is the retrospective RIS system in place in Germany. Such an ex post system would serve a number of different purposes:

- Ex post audits would increase the accountability of regulators for their analyses and therefore increase the incentives to produce quality RISs. RISs that might be found to be consistently unrealistic could then lead to sanctions or would at least draw attention to the department in question.

- In addition to incentive effects, ex post audits of RISs would also assist both the ORR and the relevant departments in gaining a better understanding of what practices and methodologies are more effective in achieving specific outcomes.

Introduction of a significance test and two stage approach

Currently it is up to the ORR to determine whether a regulation is 'significant' enough to warrant preparation of an RIS. The criteria for significance are not precise ones and it is ultimately up to the judgement of the ORR on what regulations qualify. This approach may be sensible to the extent that it:

- Does not prevent the ORR from scrutinising specific RISs, and hence leaves an element of uncertainty with departments as to whether their RISs will be reviewed by the ORR; and

- Unambiguously defining a figure for what constitutes 'significant' may create incentives to structure regulatory proposals to avoid RIS requirements e.g. by splitting up a regulatory proposal into smaller impact proposals which go under the threshold.

However, a two-stage approach to the formulation of RISs could usefully improve their average quality. While the RIS requirements would remain applicable to all regulations found to be significant, the drafting of RISs would pass through two stages:

- The first stage would be for the regulator to produce a preliminary RIS for public comment. This RIS should involve a Regulatory Options Test. The Options Test would set out the various means of achieving the objectives of the regulator.

- A second stage test would then require quantification of the costs and benefits associated preferred option(s) further to feedback received from consultation. The quantification and analysis required would have to be undertaken using the most rigorous analytical methodology (e.g. cost benefit analysis) where feasible as per under the option discussed immediately above.

3.2.5. Recommendations

I recommend that the following measures to improve the average quality of RISs be further explored and developed:

- Greater standardisation and consistency of RIS format;
- The full and transparent inclusion of assumptions, data, and analysis undertaken in any quantification performed;
- The collation of improved databases to assess industry-specific administrative burdens;
- The requirement to adopt a rigorous analytical and quantitative technique and to justify the choice of analysis with a fully quantified CBA as first preference; and
- The introduction of a two-stage approach to RIS requirements and consideration of a range of alternatives.

3.3. OTHER ISSUES

In this section I briefly comment on the transparency of RISs processes. At present, not all RISs are publicly available in Australia, suggesting poor transparency. Furthermore, improved skills transfer between the ORR and government departments may also improve the quality of RISs.

3.3.1. Transparency and Training – The approaches of other jurisdictions

The **United States** Office of Information and Regulatory Policy (OIRA) publishes detailed information which is updated daily on the Office of Management and Budget website about the regulations and impact analyses it has reviewed, comprising among other things a table of regulations by agency and type of action taken. Copies of correspondence with agencies are also available on the website, setting out the reasons for action taken as well as information on meetings and written correspondence from outside parties on regulations under review by OIRA.

Mexico's Economic Deregulation Unit (UDE) publishes on its website, a listing of all proposals currently under review and indicates if they complied with RIS requirements. In addition, Mexico has an innovative grading system for RISs which has been recommended by the OECD. To track the quality of RISs, fourteen elements of RISs are assessed, and a grade ranging from minus 2 (very bad) to plus 2 (very good) is assigned to each. The scoring system is then used as the basis for targeting technical RIS assistance, demonstrating how better reporting systems can translate into better future results. Greater assistance is provided to those ministries and agencies where previous scores have been low.

3.3.2. Options for reform and recommendations

Greater transparency may also encourage greater involvement by affected businesses in the RIS process. Requiring all government departments to make all their RISs available on their websites would be a simple and low-cost means of achieving this objective.

In addition, stronger public reporting could facilitate continuous improvement in regulatory decision making by allowing the ORR to target better training at government departments which are lagging in the quality of their RISs produced.

4. SUMMARY AND RECOMMENDATIONS

My assessment of a sample of RISs and the evidence provided by the Property Council suggests that the central concern with the current RIS framework relates to low compliance with ORR criteria, which is in turn a reflection of the poor quality of analysis contained in RISs, and the lack of integration of RISs into decision making processes. The risk is then that the impact of regulations – in terms of the benefits and direct and indirect costs that may arise from it – are not properly assessed, and that society is made worse off as a result.

With respect to the issue of RIS quality, my survey of a random sample of 32 RISs found that the quality of those RISs judged as 'adequate' by the ORR is of a generally low standard. 77 per cent did not attempt to quantify the costs of regulation. In particular, compliance costs were rarely quantified. Furthermore, I also found frequent use of vague language in the RISs when discussing costs and benefits, while 31 per cent of the sample did not have a comprehensive analysis of policy alternatives. This would suggest that only a cursory attempt has been made to set out, let alone quantify, the consequences of a regulation.

Overall, the RISs scrutinised by the Property Council are characterised by the following deficiencies:

- Selective use of data used in quantification of costs and benefits;
- Poor and unrealistic assumptions underpinning the analysis; and
- Inconsistent presentation of costs and benefits;

I recommend that the following measures to better integrate RIS into the regulatory decision-making process be further explored and developed. Such a measure would also support transparency objectives, as well as imposing some discipline on government agencies to ensure that RISs that are undertaken represent a more realistic assessment of the consequences of a regulation:

- Mandatory consultation with a minimum consultation period for all proposed regulations above a minimum materiality threshold, and differentiated according to the significance of the regulation in terms of its likely (direct and indirect) cost consequences, and requiring the publication of a draft RIS at the start of the consultation period;
- A requirement on the relevant Minister to certify that the RIS process has been followed, and that the RIS adequately assesses the impact of the proposed rule;
- The regular secondment of ORR staff to government departments to enable an improved 'culture of compliance';

- The right by the ORR to veto significant regulations judged to have been inadequately assessed under an RIS; and

- The removal of local government and planning legislation exemptions from RIS requirements, at least above a certain materiality threshold.

My analysis has also highlighted that the quality of the analysis undertaken is often very limited, and the absence of consistent minimum standards in terms of RIS content. I recommend that the following measures to improve the average quality of RISs be further explored and developed:

- A greater degree of standardisation and consistency of RIS format to highlight the conclusions that can be drawn from it;

- The full and transparent inclusion of assumptions, data, and analysis undertaken in any quantification performed;

- The collation of improved databases to assess industry-specific administrative burdens;

- The requirement to adopt a rigorous analytical and quantitative technique and for the agency in question to justify the choice of analysis; and

- The introduction of a two-stage approach to RIS requirements and consideration of a range of alternatives.

Finally I also recommend the following measures to enhance transparency and improve training in RIS compliance

- Legislating to require all government departments to make all their RISs available on their websites.

- 'Scoring' government departments' RIS quality and consequently directing ORR training towards the lagging departments with the aim of improving their future RISs.