1 The role of Regulation Impact Statements in improving regulation

The Regulation Impact Statement (RIS) process is recognised internationally as playing a pivotal role in improving the quality of regulation. RIS processes also reinforce other processes of government designed to improve the quality, transparency and administration of regulations. In 2003-04, RIS processes were reviewed and strengthened by several Australian jurisdictions. Nevertheless, some regulators continue to experience difficulties in complying with such best practice processes.

Regulations are essential for a properly functioning society and the economy. The challenge for government is to deliver effective and efficient regulation — *effective* in addressing an identified problem and *efficient* in minimising compliance and other costs on the community.

Increasing global competition, advances in technology and changes in community values have resulted in many member countries of the Organisation for Economic Cooperation and Development (OECD) undertaking substantial regulatory reform since the mid-1980s. While this has been most evident in industries such as electricity, rail, shipping, airports and telecommunications, there has also been a significant focus on corporate governance, environmental, public health and safety regulations.

Some compliance costs are a necessary by-product of any regulatory system. However, regulation that fails the tests of efficiency and effectiveness can impose unnecessary costs, as well as impede innovation and productivity. These costs of regulation may sometimes only become apparent over time.

In Australia, there has been growing concern about the complexity of regulations associated with recent increases in the number and average length of regulations (Pender 2004). As society becomes more diverse, it is inevitable that regulatory systems will become more complex. However, many groups in the community — especially small business — are concerned that the growing complexity of regulations also reflects ‘regulatory inflation’, which is creating unnecessary burdens and making compliance more difficult for business and other affected groups.

Regulatory compliance costs are difficult to estimate, but appear to be substantial, both for individual businesses and the broader community. For example, the OECD estimated in 1998 that, for a limited set of regulations, regulatory compliance costs for small and medium sized businesses in Australia exceeded $17 billion per year — equal to $33,000 for each business (OECD 2001).

In a major new international study, the World Bank (2004a, 2004b) has scrutinised the regulatory systems in over 130 countries. The study measures the time, cost and effort required to manage key aspects of a business, such as establishing a business, hiring workers, obtaining credit, enforcing contracts, securing payments from debtors and resolving bankruptcy issues. It found that Australia ranks highly vis-a-vis other countries on a range of outcome measures, such as the time and cost involved in meeting regulatory requirements to start a business. Some of Australia's current labour market regulations also rate highly, such as flexibility in hiring. In contrast, Australia fares poorly compared to some other countries in the time and cost incurred in enforcing contracts. For example, according to the study it takes on average 157 days to enforce a contract in Australia, compared to 50 days in New Zealand, 69 days in Singapore and 48 days in the Netherlands. The study (which has been extended to more countries) also suggests that, for countries with poor quality regulation, there can be a significant return to regulatory reform in increased economic growth.

1.1 Regulatory review and reform policy

Experience in Australia and overseas has shown that good regulation typically has the following characteristics (Argy and Johnson 2003, p. 6).

- It is *not unduly prescriptive*, being performance or outcome oriented, with the flexibility to accommodate changing circumstances and to allow businesses and others to choose the most efficient and effective means of compliance.
- It does *not restrict or distort competition* and allows market forces to operate without adverse effects.
- It is *predictable and responsive to business and the community*, so that they can make decisions with certainty and confidence.
- It is *clear and concise*, so that it is accessible to those affected by it and can be readily understood.
- It is *consistent* with other laws, agreements and international obligations.
- It is *enforceable*, yet embodies incentives no greater than necessary for reasonable enforcement and for maintaining compliance that is not unduly costly.

- It is *administered in a fair and transparent* manner, with proper accountability and appeal mechanisms.
- It is *monitored and periodically reviewed* to ensure that it continues to achieve its objectives.

Good processes are the key to achieving good regulation. They help ensure that regulation making has clear objectives, is well informed, takes a whole of society perspective and engenders community confidence by providing certainty and transparency about the reasons for and effects of regulation.

In Australia and many OECD countries, a central element of good regulation making is the use of Regulation Impact Statement (RIS) processes. A RIS formalises and documents the steps in developing good regulation. It is prepared by the department/agency developing regulation and aims to ensure that regulation achieves its objectives in the most efficient and effective way.

The benefits of the RIS process include providing a systematic, consistent and transparent framework to assess the benefits and costs of government regulatory action. RISs clarify information about impacts for decision makers and help make economic, social, environmental and other trade-offs explicit. In these ways, RISs can promote regulation that brings the greatest net benefit to the community (OECD 2002, p. 45).

1.2 International regulatory developments

There is a growing recognition internationally that governments need to have systems in place to ensure the quality of regulatory outcomes. Although not a new concept, RISs have become one of the main initiatives employed by OECD countries to improve the quality of regulation and promote regulatory governance. Related tools include the systematic consideration of regulatory alternatives, wider public consultation and improved accountability arrangements (OECD 2002, p.11).

Although only two or three OECD countries were using RISs in the early 1980s, by the end of 2000, 14 of 28 OECD members had adopted universal RIS programs broadly similar to that used by the Australian Government. A further six were using the RIS approach for some types/categories of regulatory proposals (OECD 2002, p. 45).

The United States (US) and the United Kingdom (UK) are leading countries in implementing regulatory quality control processes — including the use of RISs.

- At the federal level in the US, RISs are required for all significant rules, regardless of the extent to which an agency is permitted by law to consider risks, costs or benefits when issuing regulations. Agencies are required to identify and assess alternatives to direct regulation and are encouraged to allow 60 days for comment on proposed regulations. An independent agency — the Office of Management and Budget — is responsible for oversight of the US Government's regulatory quality assurance system.
- In the UK, regulatory impact assessment for proposals that affect businesses, charities or voluntary bodies was introduced in 1998. The Regulatory Impact Unit, located within the UK Cabinet Office, works with departments, agencies and regulators to ensure they prepare robust RISs. The UK approach requires: consideration of alternatives to regulation, RISs to be included as part of ministerial correspondence seeking collective agreement for 'significant proposals' and early and effective consultation with those affected (Cabinet Office (UK) 2003).

While most OECD countries now use RISs, many are strengthening and enhancing their requirements (Argy and Johnson 2003 and appendix G).

1.3 Regulatory policy in Australia and the use of RISs

RIS processes adopted by the Australian Government and Council of Australian Governments (COAG) are recognised internationally for integrating best practice processes into regulatory policy-making. RIS processes apply to approximately 60 Australian Government regulators and national standard-setting bodies, and a further 40 Ministerial Councils. They encompass the main tools — including the systematic consideration of regulatory alternatives, public consultation and accountability — which the OECD has identified as essential to improving the effectiveness and efficiency of regulation.

Box 1.1 Australian Government RIS processes

RISs are mandatory for significant regulations, including international treaties, that have the potential to affect business or restrict competition.

RISs should address a number of key elements. These include an assessment of the problem or issue being addressed and a clear statement of the objective of government action. The problem should be carefully defined, with evidence of its nature, magnitude and impacts. The objective should be explicit in addressing the problem, but not pre-justify a certain course of action. The RIS then assesses feasible options, includes a cost-benefit, impact and risk analysis of each option, and provides justification for the preferred option. It also summarises the consultation process and views of stakeholders on the issues being addressed. In addition, the RIS should address how the regulation will be implemented and when it will be reviewed.

The primary role of a RIS is to ensure that all relevant information is presented to the decision maker. After a decision is made, the RIS may be tabled in Parliament or otherwise made public, promoting transparency about the basis for a decision.

The ORR is required by the Australian Government to advise agencies developing regulatory proposals whether a RIS is necessary and to assess the adequacy of all RISs prepared by agencies.

Agencies are required to consult the ORR at the earliest practicable stage in the policy development process as to whether a RIS is required. Failure to consult with the ORR, prepare a RIS where one is required, or prepare a RIS of an adequate standard can trigger a number of responses, including the ORR providing an adverse report to the decision maker and non-compliance being reported in *Regulation and its Review*. The ORR can also brief the Parliamentary Secretary to the Treasurer, who can address the matter at Ministerial level.

Source: derived from *A Guide to Regulation* (ORR 1998).

The ORR, which is part of the Productivity Commission and shares its statutory independence, plays an 'umpire' role — it focuses on the process and does not advocate or support particular policies or regulatory outcomes. The ORR reports to decision makers on a regular basis and to the broader community annually — through *Regulation and its Review* — on the adequacy of analysis within RISs.

Since 1995, COAG has applied a nationally consistent assessment process to proposals of a regulatory nature considered by Ministerial Councils and national standard-setting bodies. The major element of the COAG assessment process is the preparation of RISs for regulatory proposals. Under the COAG guidelines, the ORR is required to assess the adequacy of the RIS at two stages — prior to public consultation and prior to a decision being taken by the Ministerial Council or national standard-setting body. The application of the COAG RIS process by

Ministerial Councils and national standard-setting bodies is discussed in appendix C.

New Zealand and a number of Australian jurisdictions (such as Victoria and the Northern Territory) have recently implemented RIS systems broadly modelled on the approach taken by the Australian Government. The RIS requirements employed by Australian States and Territories are discussed in appendix F.

Recent developments

A number of recent developments are directly relevant to either the COAG or the Australian Government RIS processes. These include new RIS initiatives by COAG, the *Legislative Instruments Act 2003* and the Government's cost recovery impact requirements.

COAG RIS initiatives

In June 2004, COAG re-endorsed and strengthened the COAG RIS guidelines, particularly in relation to the ORR's role in assessing the adequacy of COAG RISs for consultation and decision making. Other changes included clarification that the guidelines apply to COAG itself and identification of cases where RISs may not have to be prepared — such as when a Ministerial Council or national standard-setting body develops a regulation to meet a genuine emergency situation, or where there is preliminary 'brainstorming' by Ministers. There is also a new requirement for the ORR to work closely with its New Zealand counterpart — the Regulatory Impact Analysis Unit — in assessing draft consultation RISs involving New Zealand issues, such as trans-Tasman mutual recognition (COAG 2004a).

Legislative Instruments Act 2003

The Act requires all legislative instruments — made in the exercise of a power delegated by the Parliament — to be recorded on a Federal Register. Examples include regulations, ordinances, determinations or other written instruments that determine the law. The electronic register will allow individuals and businesses to access all Commonwealth instruments and related material in one place via the Internet. Under the Act, legislative instruments will typically sunset after 10 years in operation.

Importantly, the legislation requires Commonwealth rule-making agencies to consult appropriately with the community before making a legislative instrument, particularly if the instrument will affect business or restrict competition. These

provisions aim, in part, to strengthen and promote regulatory best practice and complement the RIS requirements.

Cost recovery impact statements

In 2003, the Australian Government decided that, where appropriate, RISs should also include a Cost Recovery Impact Statement (CRIS). A CRIS is prepared for proposals to introduce or amend significant cost recovery charges.

If a regulatory proposal includes a cost recovery element, the ORR assesses the RIS against the Government's RIS requirements and also the Department of Finance and Administration (DoFA) Cost Recovery Guidelines (2003). Where a separate CRIS which has no regulatory implications should be prepared, it is assessed by DoFA. The ORR liaises closely with DoFA, including on issues that might trigger the CRIS requirements.

Measuring the impacts of RIS processes

Measuring the impacts of RIS systems on the quality of regulation is a difficult and complex task. However, a number of partial measures illustrate the positive impacts of the RIS process on regulatory outcomes. For example, analysis by Hahn (1998) of the impacts and outcomes from the use of RISs by OECD countries concluded that RISs have helped reduce the number of unnecessary and burdensome regulations.

Other benefits of the RIS process have been clearly evident in Australia, particularly in assisting governments to prepare better quality regulations. The RIS process has sometimes resulted in draft options and recommendations being revised and modified before the decision-making stage. For example, in mid-2002, the Australian Building Codes Board released for public comment a draft RIS dealing with the regulation of energy efficiency for houses. Following feedback on the RIS from public consultation, the preferred option was extensively modified, resulting in more streamlined implementation arrangements.

RISs are intended to identify the best response to a particular policy problem. In 2003-04, the preferred regulatory option changed during the policy development process — between preparation of an early draft RIS and consideration by the decision maker — in about ten per cent of cases where RISs were prepared. This illustrates the contribution of RISs in highlighting to decision makers potential regulatory responses which may better address particular problems.

1.4 Why do some regulators find preparing RISs challenging?

In 2003-04, the Australian Government introduced approximately 1700 regulations, comprising 150 Bills, 1538 disallowable instruments and 29 international treaties. The ORR provided advice to regulators on 845 regulatory proposals and advised that RISs were required for 174. Many of these regulatory proposals were not considered by decision makers by 30 June 2004, so that in the year to 30 June 2004 only 114 matters required a RIS (appendix E). Therefore, in 2003-04, less than 7 per cent of all regulations which were considered by decision makers required the preparation of a RIS.

Over the last six years, compliance with the RIS requirements has generally increased, notwithstanding the fact that the ORR has been progressively increasing the minimum adequacy standard. In 2003-04, 18 of the 22 departments/agencies required to prepare RISs complied fully with the RIS requirements. There has also been a large improvement in compliance for significant proposals (see chapter 2 and appendix A). Many departments and agencies now have internal systems for developing regulation which incorporate the RIS process. In these circumstances, the preparation of a RIS usually requires little additional work by the regulator.

However, some departments and agencies continue to experience difficulties in applying the RIS requirements, either by not preparing a RIS when one should be prepared or preparing a RIS that contains an inadequate level of analysis (see chapter 2 and appendix A).

There can be legitimate reasons for a failure to prepare a RIS before the Government makes a decision — for example, the need to respond to a genuine emergency, where regulation must be introduced quickly. The failure to prepare a RIS in an emergency situation is not deemed to be a breach of the RIS requirements. However, such cases are rare and the RIS requirements are sufficiently flexible to cater for them.

Feedback from departments and agencies that have experienced difficulty in complying fully with the RIS process suggests this often is a result of:

- preparation of RISs late in the policy development process;
- poor integration of the RIS requirements into policy development processes; and/or
- duplication of policy development processes.

A common scenario is where RISs are prepared late in the policy-making process. This can be a sign of poor internal management and planning, or underestimation of

the complexity or impacts of a regulatory proposal, resulting in insufficient time to collect information, properly assess those impacts and consult the ORR.

Some departments and agencies may not be familiar with the RIS requirements, notwithstanding that they have applied for several years. This can occur when a department or agency is seldom required to prepare a RIS or where staff turnover has resulted in the loss of staff with familiarity with the RIS process.

In addition, the political process can sometimes result in the need to develop significant regulation in a short period of time. In these circumstances, it may be difficult for departments and agencies to follow best practice processes.

1.5 Future directions in regulatory reform

In recent years, the concept of ‘regulatory policy’ has evolved into a wider focus on ‘regulatory governance’ (OECD 2002). This development recognises that the tasks involved in exercising regulatory authority extend beyond the design and implementation of regulatory instruments, or their coordination, and embrace governance issues such as transparency, accountability, efficiency, adaptability and coherence. Developing and implementing the concept of regulatory governance is the focus of the regulatory policy agenda in many OECD countries.

Improved transparency in the making and administration of regulation is regarded by the OECD as the most pressing area for improvement in many countries that have regulatory impact analysis requirements (OECD 2002, p. 65). The OECD argues that increased transparency helps address various problems in regulation making, including regulatory capture or bias, decisions based on inadequate information and lack of accountability.

In Australia, RIS requirements are supported by a range of other policy programs and processes of government that seek to improve the transparency of Australia’s regulatory systems. For example, the Australian Government requires regulators to prepare regulatory plans which contain information on recent regulatory changes for the year just ended, as well as activities that could lead to regulatory review and change in the year ahead.

Regulatory Performance Indicators (RPIs) also seek to enhance the quality of regulation. For government departments and agencies, performance measurement processes have an important role to play in ensuring that government resources are used efficiently and effectively. The Office of Small Business (OSB), within the Department of Industry, Tourism and Resources, in partnership with Australian Government departments and agencies, has developed six objectives and nine

indicators relating to regulatory activities. These are intended to provide an indication of the extent to which agencies responsible for business regulation are implementing good regulatory practice. To avoid duplication of effort, the ORR provides the OSB with information it collects through the RIS process on four of the nine indicators. The performance indicators are published by OSB.

National Competition Policy (NCP) has been a major initiative to improve the quality of regulation. Under NCP, any new legislation that restricts competition needs to be accompanied by evidence that the benefits of the restriction to the community as a whole outweigh the costs, and that the objectives can only be achieved by restricting competition. Also under NCP, Australian, State and Territory governments have been obliged to review and, where appropriate, reform legislation that restricts competition. (The Australian Government's legislation review program is discussed in appendix D.)

Effective and accessible appeal provisions complement other measures to improve transparency and strengthen regulatory governance. In Australia, some decisions of regulators are subject to administrative review. A smaller number of decisions are subject to judicial review — 'the ultimate guarantor of transparency and accountability' (OECD 2002, p. 75). Other avenues of review include the Commonwealth Ombudsman and the Inspector-General of Taxation (PC 2003).