

# SUBMISSION



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## *Submission to Productivity Commission (PC) review of Regulation Impact Analysis*

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## *Contents*

|  |   |
|--|---|
| Centre for International Economics             | 4 |
| Problems of timing                             | 4 |
| A staged review process                        | 6 |
| The size of assessments and what gets assessed | 7 |

## *Centre for International Economics*

The Centre for International Economics (CIE) is an independent economic consultancy which has been in business for more than 25 years. Over this time, we have completed numerous Regulation Impact Statements (RISs) as well as more specific cost benefit analyses used to guide subsequent Regulatory Impact Analysis (RIA) work.

Our experience has covered both State and Commonwealth government levels, giving us an insight into the relative merits of the systems at a broad level.

For the Commonwealth Government, The Office of Best Practice Regulation (OBPR) Handbook and the seven step process for conducting a RIS are robust and world's best practice. The CIE believes that this model should be followed at the state level. There are two important functions performed by the OBPR: its role as an independent expert advisor to determine whether a project is meeting best practice requirements and the provision of best practice requirements themselves.

## *Problems of timing*

The main problems TheCIE encounters with RISs relates to timing and expectations.

- One problem is where the RIS is conducted prematurely before any substantive preliminary work has been done on:
  - the nature and size of problem
  - the logic of the objectives and the rationale for intervention
  - defining the policy mechanisms and alternatives.
- The other problem is when it is conducted too late after considerable policy design effort has been conducted but before any preliminary economic analysis of the economic problem, the logic of the objectives, the case for government intervention and the size of the problem.

### *Too early*

If the problem, size of problem, clear objectives and policy mechanisms are not defined when a request for tender for a RIS projects is issued, the expectation is usually that the RIS will still follow through all seven consecutive steps of the OBPR guidelines. Moreover, the expectations of stakeholders and often the regulating agency is that a *primie facie* case has been made for intervention when this is often not so. Under these circumstances, often the expectation is that it is the role of the consultant to make the case for intervention and to define the policy mechanisms to solve it. That would be acceptable were it recognised that this is a preliminary (and potentially large) step before a full scale RIS should be conducted and that the issue of intervention is still an open question. It may be that with some preliminary work

and close engagement with the regulating agency it can be shown that a significant problem exists and an efficient policy mechanism can be devised. Alternatively, it might be shown that the problem does not require intervention or is too small to warrant a full scale RIS. However, if expectations have already been raised, reining them back in may not be within the scope of the job.

If the problem and policy mechanisms are not reasonably defined, the other steps of the RIS process tend to become somewhat unbounded and confused. The relevance of the exercise is not clear and it may seem like a benefit cost analysis looking for a problem or indeed a regulatory agency looking for a cause. This impedes stakeholder consultation, data collection and analysis.

Where data collection for the RIS and RIA depend heavily on stakeholder consultations and the process is started too early, stakeholders may be reluctant to provide data and information on market effects for a number of reasons.

- They may be unsure of how the proposal would affect them, finding it difficult to assess the potential impact of the regulation, given the uncertainties around the policy variables and how these will be treated in the drafting of the legislation. Occasionally, seemingly small variations in the drafting of legislation may result in a significantly different assessment of the expected costs and benefits to stakeholders.
- They may be unsure of how the information will be portrayed in the final analysis, and worry that the policy proposed may evolve in a direction that is detrimental to them.

### *Too late*

The issuance of RIS requests too late in the political process is a reasonably common issue that TheCIE has encountered over the years and potentially more problematic than an early start.

In such situations, there is generally significant political expectation around the proposed policy or legislative change and a substantial amount of work has already been undertaken. In these circumstances the RIS can appear to represent an attempt to rubber stamp the proposed changes with too little time allocated for a substantive or rigorous analysis and inappropriate expectations that a predetermined answer will be supported.

Sunk administrative costs also provide a bias to some RISs that are issued quite late in the policy development process. This occurs when, for example, highly detailed policy mechanisms may have been developed over several years and have cost possibly hundreds of thousands of dollars to develop. This creates considerable pressure toward finding a positive net benefit and another bias if the cost is to be treated as sunk.

## *A staged review process*

A staged RIS/RIA process could overcome the timing issue.

The current (2010) RIS processes outlined on OBPRs website require agencies and departments to notify OBPR of a proposed regulatory change or introduction prior to any work being undertaken. The decision is then made as to whether or not a RIS is required – depending on whether or not the proposed change is minor or machinery in nature. If a RIS is required, it is to include:

1. the problem or issues that give rise to the need for action;
2. the desired objectives;
3. a range of options (regulatory and non-regulatory, as applicable) that may constitute feasible means for achieving the desired objectives;
4. an assessment of the impact (costs, benefits and, where relevant, levels of risk) of a range of feasible options for consumers, business, government and the community;
5. a consultation statement;
6. a conclusion and recommended option; and,
7. a strategy to implement and review the preferred option.

A staged RIA process could help ameliorate the sorts of problems discussed above. Were OBPR (or a state based equivalent) to require steps 1, 2 and 3 to be conducted as part of a preliminary RIS for initial review, the opportunity would exist to ensure the rest of the RIS is relevant and appropriate and, importantly, whether it is worth pursuing.

In the 2007 OBPR Best Practice Regulation Handbook, a preliminary assessment was indicated as an initial step, but the decision criteria used to proceed appears to have related mostly to whether the proposed regulation would have more than a low impact on businesses and individuals. The decision criteria did not relate to the relevance of the problem and its size or to the logic of the objectives, the rationale for government intervention and the efficiency of policy mechanism to address the issue. Many policy initiatives can be judged to be worthwhile in principle before progressing to test empirically whether the benefits will exceed the costs.

In cases where the OBPR judges that a preliminary assessment fails to make a case for regulation, but the regulating agency wishes to progress with the policy initiative a full RIS should still be required to reveal the net costs of the proposed initiatives so that policy decision makers are fully informed.

### *The size of assessments and what gets assessed*

The nature and size of the regulatory problem or market failure should determine the scope and scale of the associated RIS or RIA. This is an echoing of the findings of the OECD Council on Regulatory Policy and Governance which recommends the adoption of 'ex ante impact assessment practices that are proportional to the significance of the regulation'.

These principles imply that regulatory changes that are likely to have a significant effect on the Australian economy should be subject to sufficient RIA process, and alternatively, regulatory changes that are unlikely to have a significant effect on the Australian economy should not be subject to costly and lengthy RIA processes when alternate assessment or cost benefit options may suffice.

Presently, some important regulatory changes are escaping the review process, particularly following the decision to exempt election promises from RIA processes. At the same time, full RISs are often required for proposed regulatory changes which do not target significant economic problems.