
Challenges for Australia in Regulatory Reform*

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Regulation is essential to the proper functioning of a society. Whether through primary or delegated legislation, or more informal arrangements, rules create order and the basis for stability and progress. They shape incentives and influence how people behave and interact. And they can help societies deal with otherwise intractable economic, social and environmental problems.

All of this goes without saying. The more important issues have to do with the appropriate form and content of regulation. While good regulation is essential to achieving desirable social and economic goals, bad regulation can undermine a society's capacity to achieve both. The post-war divergence in performance among countries with different regulatory and governance structures has provided ample illustrations of this.

There is no such thing, however, as a single regulatory ideal or a permanent general solution to a society's regulatory needs. All regulation has both positive and negative attributes. And most of it tends to obsolescence as a country's economic, social or environmental circumstances evolve. This is particularly evident today with the rapid changes brought on by technological advances and global integration.

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Australia, like other countries, therefore faces two principal challenges in the regulatory domain. The first is to rid itself of bad or redundant regulation. The second is to ensure that new regulation is ‘good’ regulation.

We have made some important progress in recent years, at the Commonwealth and State – and indeed interjurisdictional – levels. But we still have some way to go.

What is ‘good’ regulation?

So what is good regulation? What are its principal characteristics and how can we ensure that we attain them?

At the broadest level, the answer is almost tautological: good regulation is regulation which, in achieving its goal, brings the greatest net benefit to the community. But the little word ‘net’ is important. It signifies that regulation must be judged not only by its beneficial effects, but also by the costs that arise in achieving them.

For this overall net benefit requirement to be satisfied, regulation needs to meet three other tests:

- regulation must be the most effective way of addressing an identified problem;
- it must impose the minimum burden on those regulated; and
- cause the minimum amount of collateral damage to others.

Experience both within Australia and internationally has shown that, in order for it to meet these tests, regulation needs to exhibit some important design features:

- *Regulation should not be unduly prescriptive.* Where possible, it should be specified in terms of performance goals or outcomes. It should be flexible enough to accommodate different or changing circumstances, and to enable businesses and households to choose the most cost effective ways of complying.
- *Regulation should be clear and concise.* It should also be communicated effectively and be readily accessible to those affected by it. Not only should people be able to find out what regulations apply to them, the regulations themselves must be capable of being readily understood.
- *Regulation should be consistent* with other laws, agreements and international obligations. Inconsistency can create division, confusion and waste.

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- *Regulation must be enforceable.* But it should embody incentives or disciplines no greater than are needed for reasonable enforcement and involve adequate resources for the purpose.
 - Finally, regulation needs to be *administered by accountable bodies* in a fair and consistent manner, and it should be *monitored and periodically reviewed* to ensure that it continues to achieve its aims.

Much regulation fails the tests

Clearly, a regulator's life wasn't meant to be easy. The Productivity Commission – whose role it is to assess regulation and advise Australian governments on how to do better – finds that most regulation it looks at fails at least some of these tests – and some regulation fails most of them!

Experience has shown that regulation that restricts or distorts competition – the traditional inquiry focus of the Commission and its predecessors – has mainly imposed net costs on the Australian community. This includes regulations that restrict entry to markets or provide privileged treatment to 'insiders'. Regulation of this type removes important incentives for enterprises to achieve higher productivity, lower prices and generally to be responsive to the needs of customers. It has been the target of a systematic, interjurisdictional program of review under the National Competition Policy which, although not complete, has led to some important reforms.

Arguably the most costly anti-competitive regulation, given Australia's relatively small economy, has been the protection of our domestic markets from international competition. It is now generally accepted that the very high levels of import protection that prevailed throughout the post-war decades, provided an effective shield mainly for inefficiency. It seems more than coincidental that indicators of business R&D and innovation, as well as national productivity and exports, all increased significantly from the late 1980s when general reductions in import protection began to take effect.

In the past decade or so, successive Commonwealth governments, in consultation with the States, have asked the Commission to look at an increasingly diverse range of policy areas – including environmental and social regulation. Regulatory deficiencies have been manifest in all of them.

For example, our examination of private health insurance in 1997 revealed that the regulatory framework at that time was promoting 'hit and run' behaviour and

deferred entry to funds – allowing people to ‘cherry pick’. Resulting premium increases discouraged new entry into private health insurance, placing an unfair burden on long term members (many of whom were forced out of the system just when they needed it most) and those trends in turn generated pressure for further premium increases. A ‘vicious circle’ of spiralling cost and membership decline was the result.

In the environment area, we recently found that regulation has been hindering private sector initiatives which would add to the conservation of our biodiversity in Australia. For example, Queensland legislation creates eleven different types of licences and eight types of permits in three administrative regions. A private conservation provider requires different licences or permits for the taking, keeping, displaying, trading and movement of native wildlife. More generally, we have found that economic regulation does not always adequately account for environmental impacts – and vice versa.

The Commission’s review of Commonwealth broadcasting regulation last year found that existing arrangements for introducing digital television to Australia were denying Australians the potential benefits from technological convergence and were at serious risk of failure – a judgement to which subsequent events have lent some weight.

And our current inquiry into cost recovery practices of Commonwealth agencies has found that poor regulation is often being compounded by poorly structured charges for regulatory services. Our draft report reveals that most cost recovery arrangements within government are ad hoc, lack transparency, have poor accountability and review mechanisms – and some have questionable legal grounding. As a consequence, businesses may be unfairly burdened with excessive charges for services or facilities that may themselves be inappropriate.

A final example, which may be of wider interest, is the regulation of gambling. Delegates at this conference need not venture far to find a variety of legalised gambling. With the exception of Western Australia, community based gambling is now widely spread across Australia’s pubs, clubs and newsagencies. The liberalisation of gambling has brought harmless entertainment value to most Australians. But it has also given rise to major social costs stemming from problem gambling. Indeed, in the case of electronic poker machines, the Commission found that those costs could conceivably outweigh the benefits, yielding a net loss to our society.

Apart from the questionable basis for their liberality, gambling regulations were found to be complex, fragmented and inconsistent. They were strong on financial probity – at least for some venues – but contained little provision for consumer protection or assistance to problem gamblers. They generally failed most of the tests for good regulation.

Why do we have so much *bad* regulation?

So why do governments' regulatory efforts so often fall short of the standards that we have a right, at least in democratic societies, to expect?

The quick answer is that bad regulation is easier to implement than good regulation.

The tests for good regulation are not easily satisfied. They are informationally demanding, requiring careful consideration of the policy problem to which they are directed, the alternatives available and their respective effects on various groups within society.

A variety of pressures militate against such rigorous assessments. One is time pressure. The number of new regulations introduced each year is vast and growing. (The Commission's current inquiry into non-tax aspects of Superannuation has found itself dealing with over a thousand pages of legislation!) Our political representatives justifiably complain about their inability to digest and consider all this material. But without such digestion, necessary scrutiny and debate is diminished.

A second and more fundamental force for bad regulation is the uneven political and bureaucratic pressures which favour those regulations that deliver benefits to particular constituencies. The costs, being longer term, indirect and often more diffuse in their incidence across the community, tend to be left out of the political calculus. It can be both politically and administratively convenient to ignore them.

Once introduced, however, regulation which benefits particular groups at collective cost tends to be very difficult to remove. Correcting such regulation not only imposes losses on some people, who will naturally resist change, it can also bring uncertainty and adjustment costs. Getting regulation right in the first place is therefore very important.

Good process is the key

Good regulation rarely just ‘happens’. Given the political and informational constraints, a disciplined approach to the development of regulation is necessary. Good process is the key to good regulation.

Putting it the other way, poor regulation is typically the outcome of poor regulatory processes. For example, the Commission’s examination of how the deficient gambling policies and regulations were developed revealed:

- poorly specified and sometimes conflicting objectives and rationales;
- lack of rigour in assessment of costs and benefits of alternative options;
- lack of community consultation; and
- little monitoring and evaluation of the consequences of decisions, once implemented.

This is symptomatic of a more general malaise in policy formulation. In many cases, laws and regulations throughout Australia have been put into effect without adequately addressing three questions that are fundamental to good policy-making – namely:

- What is the problem (or objective)?
- What are the regulatory and other options for dealing with it?
- What is the most cost-effective solution?

It is therefore not surprising that much of our accumulated regulation has also failed the ultimate test: demonstrating a net benefit to the community. As the New South Wales Regulation Review Committee said, in a valuable report released last year: prior to the introduction of a more systematic approach to the development of regulatory proposals in that State, the system had “allowed numerous regulations to come into being with only the barest, if any, evaluation being made of their expected economic and social costs and benefits.”

While the need to ‘do something’ will often be first perceived by political representatives – that is their job – the process of answering the questions at the core of good regulation needs to begin with rigorous work by public officials. It is only then that fundamentally different approaches to identified problems can be adequately considered. It is generally too late by the time a Bill reaches the floor of Parliament.

That is not to deny the valuable gatekeeping role of the Parliamentary Committees which scrutinise legislation. Theirs is an essential and complementary element of the process. However, it represents a final check before the passage of regulation into law. It is the policy development work beforehand that shapes the substantive provisions of regulation.

With this in view, most OECD countries have now adopted some form of regulatory impact analysis in the pursuit of regulatory best practice. The purpose of the regulatory impact statement is to ensure that proposed regulation jumps a number of hurdles designed to determine whether it is likely to result in net benefits to the community – and to preclude it from being implemented if it does not. Also, by codifying good practice, it can help embed a more disciplined, sequential, approach into the development of policy.

Australia's reforms to regulatory processes

From the late 1980s, Australian States began introducing regulatory impact analysis for subordinate or delegated legislation and, in 1995, all Australian jurisdictions, through the Council of Australian Governments (COAG), took the important step of requiring proposals going to Ministerial Councils and national standard setting bodies – which up until then had not been subject to a nationally consistent assessment process – to be accompanied by regulatory impact statements.

Of the Australian jurisdictions, the Commonwealth's quality control process arguably has the most comprehensive coverage. It is also the process with which I am most familiar and on which I will initially focus my remarks.

Since 1997, Commonwealth departments and agencies have been required under a Cabinet directive to prepare Regulation Impact Statements for all regulation that affects business. This includes primary as well as subordinate legislation, so-called 'quasi-regulation' and treaties. Regulation Impact Statements must justify the need for government regulation and consider alternative ways of attaining policy objectives. This calls for an economy-wide or community-wide perspective in identifying who benefits from the regulation, who incurs the costs and whether the regulation achieves its objectives without unduly burdening the community.

Elements of a Regulation Impact Statement (RIS)

A RIS comprises seven key elements, which set out:

- the problem or circumstances which give rise to the need for action;
- the desired objective(s);
- the options (regulatory and non-regulatory) for achieving the desired objective(s);
- an assessment of the impact (costs and benefits) on consumers, business, government and the community of each option;
- a consultation statement (describing the process and feedback);
- a recommended option; and
- a strategy to implement (including enforcement mechanisms) and review the preferred option.

The Regulation Impact Statement requirements force policy makers to consult, and to work through a sequential process of articulating the problem, assessing a range of options, recommending the best option and explaining why other options are not as good. Taken together, these elements constitute a best-practice policy development process designed to produce ‘good’ regulation. In particular, the process prompts abandonment of the traditional ‘regulate-first’ approach and seeks more careful selection and better justification of the preferred option.

A critical feature of this process – the logic of which will be obvious – is that Regulation Impact Statements are required to be presented to political decision makers in time to inform their decisions. The statements must also accompany bills and subordinate legislation into Parliament, enhancing the scope for a well-informed political debate and providing a transparent account to the community of the reasoning underpinning proposed regulation.

The Office of Regulation Review, which is part of the Productivity Commission and shares its statutory independence, is the government’s watchdog over this regulation development process. It is complemented by the Senate Scrutiny of Bills Committee and the Regulations and Ordinances Committee, which ensure that final Bills and delegated legislation conform to important principles relating to citizens’ rights and liberties.

To accord with the requirements, departments and agencies are obliged to consult with the Office of Regulation Review from the outset in preparing Regulation Impact Statements, and the Office must verify that they are of an adequate standard.

There are other requirements at the Commonwealth level which deserve mention. With the help of the Office of Regulation Review, the Office of Small Business, which is part of the Department of Employment, Workplace Relations and Small Business, collects and publishes data on benchmark indicators of good regulatory practice. These Regulatory Performance Indicators measure whether departments and agencies are following regulatory best practice and have been designed as a first step towards enabling benchmarking of government performance in regulatory reform.

In addition, there is a requirement, soon to be put into effect, for formal 'Regulatory Plans', whereby regulatory agencies must record their previous year's regulatory activity and, more importantly, their regulatory intentions for the year ahead. The purpose of the annual Regulatory Plan is to alert stakeholders to upcoming regulatory changes and, in the longer term, bring a strategic focus to the regulation making activities of these agencies. This initiative is designed to improve the transparency of regulation making and put pressure on agencies to make greater use of Regulation Impact Statements earlier in policy development.

Are we meeting the challenge?

In the Productivity Commission's latest annual report on regulation, for 1999-2000, the Office of Regulation Review recorded that of the 207 Regulation Impact Statements required in that year, 180 had been prepared for the decision maker and, of those, 169 were judged to be of an 'adequate' standard.

This translates to a compliance rate of 82 per cent, at the end of the second full year under the new regime. It was 91 per cent at the subsequent stage when bills and delegated legislation are tabled in Parliament. This represents a significant improvement over earlier years and compliance has remained at about this level in the first half of the current financial year.

Other aggregate indicators of regulatory performance at the Commonwealth level also look promising. For example, in 1999-2000:

- 92 per cent of Regulation Impact Statements were assessed as adequately addressing whether or not the proposal would provide a net benefit to the community;
- 74 per cent of agencies had organisational guidelines outlining consultation processes and practices; and

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- 47 per cent of agencies published an adequate forward plan for introduction and review of regulation.

While most of these aggregate numbers suggest relatively high levels of compliance with the Government's best practice requirements for regulation-making, they conceal some significant deficiencies.

One is that compliance varies considerably among portfolios and agencies. For the major policy-making portfolios, compliance rates in 1999-2000 for the decision-making stage ranged from a low of 28 per cent (Health and Aged Care) to a 100 per cent compliance record for some portfolios.

A second, and not unrelated, finding is that compliance appears to be weakest where it matters most. The Office of Regulation Review ranked the Regulation Impact Statements required in 1999-2000 according to the perceived economic and/or social significance of the regulations concerned. It found that non-compliance at the decision-making stage was 26 per cent for highly significant or significant proposals. This was one-third higher than for proposals ranked as being of moderate or low significance.

A third deficiency is in the *timing* of Regulation Impact Statements. To be at all useful in helping to get better regulatory outcomes, they need to be prepared as an input to decision making. In other words, they need to be embedded in the policy development process. Instead, in many cases they are being treated as an 'add-on', essentially prepared after policy decisions have already been made. In those circumstances, the Regulation Impact Statement becomes little more than a rationalisation of predetermined approaches. Its content may end up being adequate, but its role is subverted.

This tendency is apparent in the aggregate compliance statistics for primary legislation, which show a much higher rate of compliance at the time that Bills are tabled than at the earlier decision-making stage (95 per cent, compared to 80 per cent). But in many cases, even where Regulation Impact Statements have been assessed as adequate at the decision-making stage, they have emerged only at the 'death-knell'. Little time has been allowed for their preparation by bureaucrats or for their practical consideration by Ministers. It is not unusual for the Office of Regulation Review to be contacted by departments about preparing a Regulation Impact Statement only a day or two before the deadline for submitting regulatory proposals to decision-makers.

This has contributed to a fourth deficiency: in the informational and analytical content of Regulation Impact Statements. In terms of the formal requirements for

adequacy, the aggregate picture looks pretty good: only 11 of the 180 Regulation Impact Statements prepared in 1999-2000 for the decision-maker were assessed as not meeting the minimum necessary standard, scaled according to the likely impact of the regulatory proposal. But, again, this hides variation in performance among portfolios. For example, at the low end, of the 26 Regulation Impact Statements prepared by the Department of Communications in 1999-2000, nearly *one quarter* were assessed as inadequate.

It must also be said that the benchmarks for assessing a Regulation Impact Statement as ‘adequate’, while rising somewhat over time as agencies have become more familiar with the process, could still not be described as onerous. Yet in many cases, draft Regulation Impact Statements submitted to the Office of Regulation Review do not even address the elementary requirements – such as providing a clear articulation of the nature of the policy problem.

Identification and consideration of alternative options to the favoured regulation is generally also lacking – particularly non-regulatory or self-regulatory options – and there is often little attempt to collect the information necessary to quantify the costs and benefits of options, even as to orders of magnitude.

Admittedly, analysis of the costs and benefits of different options can be difficult. Often the available data will not support a quantitative assessment and some impacts may not be amenable to quantification. Some regulatory proposals may also not be significant enough to warrant a costly quantification exercise. But none of this excuses an inability to identify classes of effects, or to provide an adequate qualitative assessment of the pros and cons of different options.

Causes of poor compliance

It is inevitable that there will be some failures to meet best practice standards for regulation-making. The political pressures described previously will sometimes be too great, the available time too short, to accommodate the systematic, sequential approach that characterises good process.

However, in many cases, poor performance is not a result of exceptional circumstances, but reflective of a lingering resistance within areas of government to the disciplines of proper policy development processes – which are merely codified in a Regulation Impact Statement.

The reasons that are still too often claimed for failures to prepare Regulation Impact Statements in time – “we didn’t know we had to” or “we weren’t aware of what

analysis was needed” – are hard to explain after several years of experience, other than by a lack of commitment to the process.

Lack of commitment is manifest too in the poor quality of many Regulation Impact Statements – particularly at the draft stage when we first see them – and the fact that they are often prepared by junior staff. A lack of people within a department or agency with relevant skills is sometimes offered as an excuse, but the required skills are really no more than those needed for an agency’s core policy development function.

This underlines a broader and more serious concern that failure to comply with the formalities of a Regulation Impact Statement may reflect a deeper failure to do the policy work necessary to achieve good policy outcomes.

Doing better

So what more can be done? At the end of the day, the key to achieving commitment to good process throughout government is having that commitment at the political level. There have been some important initiatives throughout Australia to achieve that. But bringing about the necessary cultural change within regulatory agencies can take time, as the Commonwealth experience has shown.

Nevertheless, there *have* been significant improvements, at the State and Commonwealth levels, on which to build. Indeed, our federal system provides a valuable basis for jurisdictions to learn from each others’ experiences.

Key factors in the progress achieved thus far within the Commonwealth domain, have been:

- Cabinet endorsement of the Regulation Impact Statement process;
- the designation of a Minister to oversee it; and
- the involvement of the Office of Regulation Review in guiding, monitoring and helping to enforce it.

Comparable bodies to the Office of Regulation Review exist in State jurisdictions and they too play a significant role. However, they currently lack the formal independence of the ORR, being located within policy departments such as Premiers, State Development or Treasury. The Commonwealth experience is that independence is important if the duties of such an agency are to be exercised impartially and effectively. Otherwise pressure to ‘go easy’ on particular pieces of

regulation, or particular portfolios, could end up subverting the government's intent in establishing the process.

Within government administration, the most appropriate 'home' for such a body would be a department with broad responsibilities but little regulatory role. A department of finance would be one possibility, except that in State jurisdictions its functions are typically joined to tax policy or treasury responsibilities. Another possibility might be to locate such a body within Auditor-Generals, which would provide formal independence equivalent to that applying to the ORR within the Productivity Commission.

Having such 'watch-dog' institutions can make a difference, but they do not obviate the need for departments and agencies to take ownership themselves for the best practice processes embodied in a Regulation Impact Statement.

Again this must begin at the top. The problems being experienced at operational levels within departments and regulatory agencies would suggest that there is scope to do more in this respect. A logical concomitant of support for RIS processes at the political level, would be a more explicit commitment to comply by heads of agencies – even to the extent of including the observance of regulatory best practice as an element in their contracts/performance agreements.

This would not only impose a degree of discipline on senior officials, it would also *empower* them to ensure that their political masters were served with the robust information and advice that good policy decisions require – even when they are not sure they want it.

A further area where there is scope for interjurisdictional learning is the *coverage* and degree of enforcement of RIS obligations. A number of States have long had statutory requirements for the application of RIS processes to new subordinate legislation and reviews of existing regulations. The Commonwealth has for some considerable time had a draft Bill in play to achieve a comparable result. It establishes a single system of legislation, publication and Parliamentary scrutiny for delegated legislation and makes cost-benefit analysis a requirement for certain regulations affecting business. It would do much to bring visibility and order to this important stratum of regulation. At the same time, as the NSW Regulation Review Committee noted in its report on that State, unless there is commitment to the spirit of the requirements, the quality and usefulness of the Regulation Impact Statements that are produced may still be lacking.

Another important provision at the State level has been the 'sun setting' of regulation. This forces policy makers periodically to consider whether regulation

remains justified. When they do so, they often find that things have changed and that adjustments need to be made. I understand that the State experience with this has generally been a positive one, although the appropriate amount of time to allow before the ‘sun sets’ is under consideration in some cases.

In respect of regulation that is redundant, while some attempts have been made at the Commonwealth level to identify and repeal such unproductive regulation, a systematic approach has yet to be followed through to the extent that the States have pursued it. (This is aside from the seven year National Competition Policy review of all Australian legislation that restricts competition – an important achievement by any standards.)

For their part, the States could learn from the Commonwealth experience in subjecting *primary* legislation to the RIS requirements. While it is true that primary legislation achieves greater transparency through Parliamentary scrutiny and debate than does subordinate legislation, it also generally has greater potential impacts on the community and thus warrants a similar degree of rigour and transparency in assessment processes. RIS processes not only help inform Government about the best regulatory approaches, the attachment of (adequate) Regulation Impact Statements to legislative bills can also help inform, and thereby facilitate, the Parliament’s decision to enact them.

That would seem an appropriate note on which to conclude a presentation in this place. At the end of the day, communities look to their Parliaments for assurance that the rules that govern them are generally beneficial. That expectation has not always been adequately met in the past. The challenge is to ensure that it *can* be met in the future. Good process is the key to that, and an important start has been made. Indeed, this international conference, hosted by the NSW Parliament, is itself a hopeful sign that further progress will be made.