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REGULATORY IMPACT ASSESSMENT

by

Professor David Parker

Cranfield Centre for Competition and Regulation Research

Cranfield University School of Management

Cranfield,

Bedfordshire, MK43 0AL, UK

Tel (0044) 1234 754378

email:david.parker@Cranfield.ac.uk

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The cost of regulation is spiralling. Manufacturing, financial services and even small businesses are struggling to keep pace with the time consuming and financially burdensome cost of new legislation and regulation required by both national government and international bodies such as the European Union.

Estimating the full economic costs of regulation – which would include both the *administrative* costs of managing regulations by Government and the (usually much larger) costs to business of complying with the regulations – is not easy. But undoubtedly the *compliance costs* are huge and often hidden. In 2005 the British Chambers of Commerce quantified the total costs of regulation on business since 1998 at £39 bn. Sir Digby Jones, the former Director General of the CBI, reported that 95% of business leaders felt that the time they spent dealing with regulation had increased over the past five years and a survey of offshoring work in 2004 by CBI/MORI concluded that regulation in the UK was playing an important part in companies' decisions to relocate abroad.

Whatever the correct figure for the regulatory burden, it is incontrovertible that regulation is extensive and seemingly growing bigger by the day. Volkswagen Group Chairman, Bernd Pischetsrieder has described EU legislation affecting the motor industry as “not creeping, but explosive”.

The Importance of Regulatory Impact Assessment

Regulatory Impact Assessment or what is sometimes referred to as Regulatory Impact Analysis has been described by the OECD as:

“an information-based analytical approach to assess probable costs, consequences, and side effects of planned policy instruments (laws, regulations etc) It can also be used to evaluate the real costs and consequences of policy instruments after they have been implemented.”

At the core of RIA is an assessment of the benefits and costs expected to result from a state regulation. A new regulation should be introduced only when it has net benefits.

However, arguably RIA's main contribution to better governance lies in improving the *process* by which the risks attached to a regulation are assessed and in promoting proper *consultation* with affected interests before a regulation is introduced.

A properly instituted system of RIA within Government has the potential to raise the quality of regulation and hence reduce the regulatory costs on business and society in general.

Where did RIA come from?

RIA first surfaced as a process within Government in the USA in the 1970s. But it achieved wider popularity after the OECD began to champion the idea and published, in March 1995, guidance on RIAs. The use of RIAs when proposing new regulations has been mandatory in British central government since 1998 and RIA guidelines were introduced for British government departments in 2000. By 2001 20 out of the then 28 OECD member states claimed to be using RIA in some form. In addition, international donor agencies such as the World Bank and the Asian Development Bank have undertaken recent initiatives to spread the use of RIA more widely to developing countries. The European Commission introduced a new Impact Assessment system in 2003.

(Place table; "The OECD RIA Checklist around here.)

Today all government departments in Britain are expected to complete a RIA setting out the risks, costs and benefits of any new regulatory measure that has an impact on businesses, charities and voluntary bodies. RIAs are required for all new regulations except for:

- proposals that impose no costs or no savings, or negligible costs or savings on the public, private or charities and voluntary sector

- increases in statutory fees by a predetermined formula such as the rate of inflation
- road closure orders.

Also, all RIAs since 2002 must also consider the implications for competition of a regulatory proposal. Where an initial test indicates that there may be an impact, departments should discuss the competition assessment with the Office of Fair Trading. Departments are also expected to pay particular attention to the regulatory impacts on small business. More recently, updated guidance to departments has increased the emphasis on investigating the wider impacts of regulation; in particular the new guidance has highlighted consideration of the impact on different racial groups, rural communities, sustainable development and the public sector.

RIA Policy in Britain

RIA has been championed within Government in Britain by the Better Regulation Task Force (BRTF) and the Regulatory Impact Unit in the Cabinet Office. The BRTF was replaced on 1 January 2006 by the Better Regulation Commission (BRC). This now provides independent advice to government about new regulatory proposals and reviews the Government's overall regulatory performance.

In the Budget in 2005 the Chancellor of the Exchequer, Gordon Brown, announced reforms to the regulatory process and the BRC is responsible for monitoring the reforms, including vetting departmental plans for administrative burden reduction.

Alongside the BRC operates the Better Regulation Executive (BRE) within the Cabinet Office, which was established in May 2005. This is tasked with promoting the Government's better regulation agenda. The BRE has overall responsibility for the Government's commitments to:

- regulate only when necessary
- set exacting targets for reducing the cost of administering regulations
- rationalising the inspection and enforcement arrangements for both business and the public sector.

The BRE is expected to implement the recommendations of two major independent reports published on Budget Day in March 2005, namely the BRTF report *Regulation – Less is More: Reducing Burdens, Improving Outcomes* and Philip Hampton's Report, *Reducing administrative burdens: effective inspection and enforcement*.

The BRE will also take forward the work previously carried out by the Regulatory Impact Unit including:

- scrutinising new policy proposals from Departments and Regulators
- speeding up the legislative process to make it easier for departments to take through deregulatory measures
- working with Departments and Regulators to reduce existing regulatory burdens affecting business and frontline staff in the public sector
- driving forward the better regulation agenda in Europe

In the UK the BRE publishes guidelines and checklists for Government departments to use when undertaking RIAs that draw on and build upon the earlier OECD guidance. Recently a Standard Cost Model has been introduced to encourage the simplification and consolidation of existing regulations.

(Place flow chart: “The RIA process around here.)

Scope for Improvement

RIA has taken off internationally and compliance in British Central Government is now, officially, 100%. However, studies of the operation of RIA (some undertaken in the Centre for Competition and Regulation Research at Cranfield) point to a number of areas for improvement.

Firstly, to date RIA has been mainly applied to new regulations (known as *ex ante* RIAs) but not to existing ones (*ex post* assessments), although the introduction of the Standard Cost Model could represent a step change in the Government's attempts to reduce the administrative burden of *existing* regulation. Arguably big benefits would come from assessing the actual impact of existing regulations in terms of the original intentions, perhaps including the original RIAs - did they get it right? Most of the regulatory burden derives from existing laws.

Secondly, RIA is concerned with both the outcome and process dimensions of government regulatory policy. A good RIA attempts to assess *all* of the regulatory effects both quantitative and qualitative – RIA should not be limited simply to quantitatively measurable impacts because this may lead to the omission of important costs and benefits. However, a number of RIAs undertaken in Britain still fail to evaluate the impacts and opportunity costs in a meaningful way.

Thirdly, risk assessment is a central part of any serious RIA because costs and benefits are often unclear. However, to date there has been insufficient attention paid to the generation and analysis of alternative options (including alternatives to regulation where appropriate). Also worrying is the tendency for departments to report single point estimates when quantifying costs and benefits with no accompanying sensitivity analysis. A range of outcomes alongside probabilities would often be far more informative - and realistic.

Fourthly, there is much evidence that the use and quality of RIAs varies across government departments reflecting differing levels of enthusiasm about the process. A series of studies by the National Audit Office has found major deficiencies in the way RIAs are implemented. Its latest report argues that RIAs are often not used in the right way, the purpose of RIAs is not always understood by policy-makers and there is a lack of clarity in the presentation of the analysis and persistent weaknesses in the assessments.

Finally, and tellingly, few RIAs have recommended the “do nothing” (don't regulate) option. The fear must be that civil servants are too reluctant to confront their ministers

by pointing out that their pet regulatory project makes no sense whatsoever. In many cases RIAs do not offer a robust challenge to proposals to regulate.

Why Business Should Care

Business moans about the regulatory burden but fails to engage with government to shape the regulatory agenda. RIA requires government departments to consult with affected interests before new regulations are introduced. But too frequently departments receive very few responses from business.

Business should not complain about the regulatory burden when it fails to take the opportunity to shape the regulatory agenda. RIA provides the opportunity for business to input into the regulatory process and thereby ensure that regulation is restricted to where it is really needed and produces net economic, social and environmental benefits.

RIA has the potential to improve Government and reduce the mounting regulatory burden on society. It has much room to do good – not least because state regulation has expanded and continues to expand, at a pace and on a scale that must be of concern to all of us. Regulation must be restricted to where there is clear “market failure” and its benefits can be demonstrated clearly to outweigh its costs. However, to ensure this, business must do its part by engaging meaningfully with the consultation process, which is such a critical component of a RIA.

This in turn requires that managers should understand and become knowledgeable about RIA so as to learn how best to influence the process. The need to address the burdens imposed by the regulatory state is too great to allow the opportunity offered by RIA to pass us by.

David Parker is Research Professor in Privatisation and Regulation and Director of the Cranfield Centre for Competition and Regulation Research.

The RIA Process

Stage 1: Identify the problem

Is regulation the appropriate response?

Yes

No

→ Regulation avoided

Stage 2 : Consultation

Are all those likely to be affected included in the consultation?

Yes

No

→ Regulation abandoned or consultation exercise repeated

Stage 3: Preparation of the legislation

Does the legislation reflect the evaluation undertaken and does it adequately address the problem?

Yes

No

→ Regulation abandoned or legislation redrafted

Stage 4: Re-evaluation of the regulation legislation during Parliamentary passage

Does the legislation still meet the objectives as originally intended?

Yes

No

→ Regulation abandoned or legislation redrafted

Stage 5: Monitoring existing regulation

Is the regulation still achieving its intended benefits and without unanticipated costs?

Yes

No

→ Abolish the regulation or amend it

Regulation remains appropriate - but still re-assess periodically

The OECD RIA Checklist

1. Is the problem correctly defined?
2. Is government action justified?
3. Is regulation the best form of government action?
4. Is there a legal basis for regulation?
5. What is the appropriate level (or levels) of government for this action?
6. Do the benefits of regulation justify the costs?
7. Is the distribution of effects across society transparent?
8. Is the regulation clear, consistent, comprehensible, and accessible to users?
9. Have all interested parties had the opportunity to present their views?
10. How will compliance be achieved?