Australian Government

# BEST PRACTICE REGULATION HANDBOOK

August 2007

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# Preface

An efficient regulatory system is essential to a well functioning society and economy and depends on having effective processes and institutions for making and administering regulation in all its forms. Following the *Report of the Taskforce on Reducing Regulatory Burdens on Business*, the Australian Government has enhanced the regulatory framework to improve the analysis applied to regulatory proposals and hence the quality of regulation.

Implicit in the enhanced framework is a commitment by ministers and their portfolios to carefully consider, at an early stage, the case for acting in response to a perceived policy problem, including addressing the fundamental question of whether regulatory action is required, or whether the policy objectives can be achieved by alternative measures which would involve lower costs for business and the community.

The Government's new requirements for regulatory impact analysis are set out in this *Best Practice Regulation Handbook*. It covers the rationale for the Government's framework, and provides guidance on the analysis and consultation which must be undertaken when developing regulatory proposals. The initial steps that policy officers need to follow are summarised in a companion *Users Guide* and *Quickstart to Regulatory Impact Analysis*. The *Handbook* has been prepared under the guidance of a Steering Committee of senior officials from the Department of the Prime Minister and Cabinet, the Treasury and the Department of Industry, Tourism and Resources. It has benefited considerably from agency feedback on a draft version trialled during 2007.

The Office of Best Practice Regulation (OBPR), established within the Productivity Commission, has been assigned a central role in assisting departments and agencies with the new requirements, as well as in monitoring compliance over time. Early contact with the OBPR, when departments and agencies are preparing regulatory proposals, will help ensure that best practice regulation making is achieved.

Canberra
August 2007

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# Abbreviations

| | |
|---|---|
| ABS | Australian Bureau of Statistics |
| BCC | Business Cost Calculator |
| CBA | Cost-benefit analysis |
| CCC | Compliance Cost Calculator |
| COAG | Council of Australian Governments |
| CRIS | Cost Recovery Impact Statement |
| DALYs | Disability adjusted life years |
| DoFA | Department of Finance and Administration |
| NPV | Net present value |
| OECD | Organisation for Economic Co-operation and Development |
| OPBR | Office of Best Practice Regulation |
| QALYs | Quality adjusted life years |
| RIS | Regulation Impact Statement |
| TPA | Trade Practices Act |

# Glossary

**Compliance costs** Compliance costs are the direct additional costs to businesses of performing the various tasks associated with complying with government regulation.

**Externality** A cost or benefit from a transaction that is received or borne by people not directly involved in the transaction. For example, a factory may pollute a river, which would have detrimental effects on other users of the river. Alternatively, the discovery of a new technology will inevitably leak to other businesses that develop rival products.

**Information asymmetry** A situation in which one party in a transaction has more information than another and this information has an important bearing on the price or terms of the transaction. For example, the seller of a house may have more information than the buyer about the quality or state of repair of the house.

**Market entry** The ability of competing businesses to enter a market. The Government may place restrictions on market entry by imposing licensing conditions or directly restricting the number of suppliers.

**Market failure** A situation in which the free market fails to generate an efficient outcome or maximise net benefits. Examples include information asymmetries, externalities and natural monopolies.

**Market power** The power held by a single supplier (business) to set a higher price of a good and maintain their market share. A necessary precondition for such power is some constraint on market entry (due to regulation patents, brand or technology advantage) which makes it difficult for competing companies to respond to such a price rise.

| | |
|---|---|
| **Natural monopoly** | A situation in which a single supplier can more efficiently serve a particular market than two or more suppliers. Examples usually involve utilities with large supply infrastructures that are costly to duplicate (such as water and electricity providers). |
| **Net benefit** | A proposal shows a net benefit where the aggregate community-wide benefits exceed the costs. Where some stakeholders lose from a proposal, others have to gain more for this condition to hold. One example would be the introduction of seat belts where the costs imposed on manufacturers have been exceeded by benefits derived from lives saved and injuries avoided. Where a range of options are available, the one in which the benefits exceed the costs by the greatest margin would be the one with the greatest net benefit. |
| **Regulatory cycle** | The cycle of developing, introducing, reviewing and possibly amending regulation to ensure it is achieving its objectives and maximising net benefits. |
| **Regulatory impact analysis** | The process of examining the likely impacts of a proposed regulation and alternative policy options to assist the policy development process. |
| **Regulation Impact Statement** | A document that details the regulatory impact assessment process, including the problem requiring government intervention, the proposed regulation and its alternatives, the impacts of the different options, and consultation with stakeholders. |

# Frequently asked questions

## Do the best practice regulation requirements apply to my department/agency?

The requirements apply to ***all*** government departments, agencies, boards and statutory authorities.

## Who is responsible for applying the Australian Government's best practice regulation requirements?

You, your department or agency and individual ministers.

## Which regulatory assessment guidelines apply to my proposal, Australian Government or COAG?

The regulatory assessment guidelines that apply to your department/agency depend on who is the decision maker for your proposal.

- If the decision maker is the Australian Government (that is, Cabinet, the Prime Minister, Australian Government ministers or other delegated decision makers), you must follow guidelines outlined in this Handbook.
- If the decision maker is an intergovernmental body (including the Council of Australian Governments, ministerial councils and standing committees), you must follow the COAG principles and guidelines (available at www.obpr.gov.au).

If you are unsure about which guidelines apply to your department or agency, contact the OBPR for guidance.

## Is there a difference between the Australian Government and COAG guidelines?

Yes. While both the Australian Government and COAG guidelines require the preparation of a Regulation Impact Statement (RIS), there are some key differences in their respective processes. In particular, under the COAG principles and guidelines, a consultation RIS must be circulated to stakeholders.

## What is meant by regulation?

Any 'rule' endorsed by government where there is an expectation of compliance, for example, primary legislation (Acts), subordinate legislation (legislative or non-legislative instruments), treaties and quasi-regulation.

## What is quasi-regulation?

Quasi-regulation includes a wide range of rules or arrangements where governments influence businesses and individuals to comply, but which do not form part of explicit government regulation. Broadly, whenever the government takes action that puts pressure on businesses to act in a particular way, the government action may be quasi-regulatory.

## Are guidance or advisory notes quasi-regulation?

Government agencies publish large numbers of rulings, guidelines, circulars and other documents which advise on, clarify or interpret existing legislation. These types of documents could be regarded as being quasi-regulatory if they add additional requirements and there is pressure on business to comply.

If this is likely to be the case, the responsible agency should undertake a preliminary assessment or contact the OBPR for advice.

## Are voluntary instruments quasi-regulation?

Instruments that are entirely voluntary (for example, complying with an industry code of conduct that is purely voluntary with no consequences for non-compliance) are not quasi-regulatory. However, whenever government is involved with development, promotion or enforcement of a voluntary instrument (such as an industry code or a standard), there needs to be an examination of whether government involvement pressures businesses to comply.

## Is the removal or revoking of a regulation caught by the regulatory impact analysis arrangements?

Yes. A preliminary assessment should be undertaken on any proposals to remove or revoke regulation.

## Do I need to undertake a preliminary assessment?

If regulation is being considered as an option to address a perceived policy problem, you must assess whether a regulatory proposal will have a potential impact on business and individuals or the economy, and whether further analysis may be required. The OBPR has developed a preliminary assessment form to guide you through the compliance cost impacts and other impacts of your proposal (see section 3.1).

## What is meant by 'community-wide perspective'?

This means canvassing the impacts on all affected parties (not just vocal special interest groups).

## What is meant by 'other impacts on business and individuals or the economy'?

'Other impacts' capture the range of impacts a regulatory proposal may have on business and individuals or the economy that may not be classified as 'compliance costs on business'. These impacts may be positive or negative, financial or non-financial, or market or non-market impacts.

## What does 'restrict competition' mean?

A restriction on competition is where a regulatory proposal directly (for example, regulatory constraint) or indirectly (for example, influences behaviour) limits the number or range of suppliers, limits the ability of suppliers to compete, reduces their incentive to do so, or limits the choices of consumers (see box 3.5).

## Do 'competition impacts' include impacts due to an increase in competition?

Yes. Competition impacts include both promotion and restriction of competition.

## My proposal has compliance costs, but how do I know if they are low?

In general, compliance costs are low when only a few businesses are affected and the costs are negligible or trivial. For example:

- changes to regulation that are machinery in nature, involving technical changes that will not have an appreciable impact on business and are consistent with existing policy (such as indexation); or
- there would be a very small initial one-off cost to business and no ongoing costs.

## What should I do if the impacts of my proposal are no/low?

Policy officers should provide a description of the proposal and record the reasons for considering that there will be no/low compliance costs on business and no/low other impacts on business and individuals or the economy. A copy of this document should then be provided to the department or agency's Best Practice Regulation Coordinator. The preliminary assessment form (available from www.obpr.gov.au) may assist with this process.

## What would be examples of proposals that would have low compliance costs and low other impacts?

The indexation of thresholds for tax measures, minor amendments to legislation to close loopholes arising from recent amendments, and amendments to add new species to endangered species lists would be examples of proposals that would usually be considered to have no/low impacts.

## If I assess a proposal as having no/low impact (and do not perform any further analysis), what are the consequences if the OBPR disagrees with my assessment?

If you assess that a proposal has no/low impacts on business and individuals or the economy and the impacts are in fact more significant, your department or agency may be found to be non-compliant with the Government's regulatory impact analysis requirements. In such cases, the proposal should not proceed to the decision maker unless exceptional circumstances have been granted by the Prime Minister. If you are unsure as to whether there are no/low impacts, or whether any further analysis is required, you should consult the OBPR.

## Who signs off on the preliminary assessment?

The preliminary assessment form should be signed by the officer who has responsibility for signing off on the proposal on behalf of the department or agency.

## Another department has introduced legislation that requires legislation administered by my department. Do I need to undertake a preliminary assessment of the changes to my department's legislation?

Yes. But your assessment should consider only the consequences of the changes you are making (that is, the other department is responsible for undertaking a preliminary assessment of the proposed changes to its legislation).

## Do I need to quantify compliance costs?

If there are likely to be medium business compliance costs, you are required to prepare a full compliance cost assessment using the Business Cost Calculator (BCC) or an approved equivalent (see part 3). The OBPR will advise you if this is the case (when you contact them after completing the preliminary assessment). Where there are likely to be significant compliance costs, the quantification of these costs will form part of the RIS.

## In quantifying compliance costs, should I consider impacts on overseas businesses affected by a proposal?

It is not a requirement to cost impacts on foreign businesses. However, proposals that affect overseas businesses may impact on competition and you should consult with the OBPR on whether a RIS is required.

## Why should I quantify compliance costs or prepare a RIS?

Quantification of compliance costs and preparation of RISs are part of the best practice regulation requirements of the Australian Government. These requirements are designed to encourage well-informed policy development, and effective and efficient regulation.

## What happens to RISs and BCC reports?

RISs and BCC reports (or their equivalent) are used to inform decision makers of the likely compliance costs and other impacts of a regulatory proposal. They are also made public and provide transparency to the Government's policy development processes.

## Do I need to prepare a RIS?

If there are likely to be *significant* impacts on business and individuals or the economy, you will be required to prepare a RIS (see section 3.3). Where a RIS is required, the quantification of compliance costs forms part of the RIS requirements. The OBPR will advise you if this is the case (when you contact them after you have completed the preliminary assessment).

## I've never prepared a RIS before and I know little about cost-benefit analysis. Who can help?

You should contact the OBPR for technical assistance and training on RISs, undertaking cost-benefit and risk analysis and using the BCC. (See part 5 for a template outline of a RIS and part 6 for information on preparing a RIS. Appendixes B and C provide an introduction to cost-benefit and risk analysis.)

## When an agency/department has no discretion in the development of some elements of a regulatory proposal (because they are specified in the primary legislation,) does the agency/department have to provide a full analysis of these elements in a RIS?

No. An agency/department needs to provide a full analysis of those elements of a proposal only where discretion is available. Where no discretion is available for elements of a regulatory proposal because they are specified in the primary legislation, it is sufficient for the agency/department to refer to the non-discretionary elements in the RIS. These elements should have been subject to the Government's regulatory impact analysis requirements when the legislation was developed.

## What happens if I don't prepare a RIS or BCC report?

No regulatory proposal can go to Cabinet or other decision maker that has not complied with the Government's best practice regulation requirements, unless 'exceptional circumstances' have been granted by the Prime Minister (see section 3.5).

Where a RIS or quantification of compliance costs was required but not prepared, a post-implementation review is required to be completed within one to two years after implementation of the proposal (see section 3.5). The OBPR will also report on those proposals granted 'exceptional circumstances' in the OBPR's annual *Best Practice Regulation Report*.

## What happens when a proposal proceeds to the decision maker without clearance of the Regulation Impact Statement by the OBPR?

Proposals should not proceed to the decision maker unless they have satisfied the Government's best practice regulation requirements.

However, in the event that a proposal proceeds (either to Cabinet or another decision maker) without an adequate RIS (or quantitative assessment of compliance costs), the resulting regulation must be the subject of a post-implementation review within one to two years and the agency/department responsible for the proposal will be reported as non-compliant by the OBPR in the *Best Practice Regulation Report* (see section 3.5 of the Handbook for more information).

## When do I need to consult with stakeholders?

Effective consultation should occur at all stages of the regulatory cycle.

Consultation early in the regulatory process will assist in identifying the nature and extent of the problem, the range of possible options for addressing it, and potential costs to consider.

The whole-of-government policy on consultation establishes the principles for best practice consultation with stakeholders as part of good regulatory process (see part 4).

## What are Annual Regulatory Plans and is it a requirement for departments and agencies to publish one?

Annual Regulatory Plans (ARPs) are public listings of upcoming regulatory activity of a department or agency. They should include planned regulatory measures and any upcoming reviews of regulation (including five-yearly reviews and post implementation reviews).

It is a requirement for departments and agencies to publish an ARP in July of each year and update them as appropriate so that stakeholders are informed about regulatory activity and consultation opportunities (see part 4).

# 1 Why regulatory assessment?

## 1.1 Introduction

Regulations are essential for the proper functioning of society and the economy. They include any laws or other government-endorsed 'rules' where there is an expectation of compliance. The challenge for government is to deliver effective and efficient regulation — regulation that is *effective* in addressing an identified problem and *efficient* in terms of maximising the benefits to the community, taking account of the costs.

While much regulation is necessary and beneficial, there are cases where this may not be so or where regulations could be better designed. There is a public perception that rule makers too often concern themselves with effectiveness, ignoring efficiency issues — that is, existing or proposed regulation may achieve a particular policy goal but not necessarily be the 'best' or lowest cost means of doing so.

The Australian Government's Taskforce on Reducing Regulatory Burdens on Business noted that governments are often attracted to regulatory solutions as a tangible demonstration of government concern, and because the costs are typically 'off-budget', diffuse and difficult to measure. As well, each regulatory solution tends to be devised within individual government agencies, with the cumulative impact being poorly understood and rarely taken into account. The Taskforce noted that a 'regulate first, ask questions later' culture appears to have developed in some departments and agencies.[1]

Determining whether regulation meets the dual goals of 'effectiveness' and 'efficiency' requires a structured approach to policy development that systematically evaluates costs and benefits. The problem to be addressed and the related policy objective should be identified as first steps in the policy development process. This should be followed by consideration of a range of options for achieving the objective (as well as a 'no action' or status quo option) and an analysis of the likely economic, social and environmental consequences. The policy

[1] Regulation Taskforce 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January.

development process should at least ensure that the benefits to the community of any regulation actually outweigh the costs, and give some assurance that the option chosen will yield the greatest net benefits.

Restrictions on competition and the cost to business of complying with regulation are areas of particular concern to the Australian Government. The cumulative impact of government regulation (Australian Government, state/territory and local) on business and individuals imposes significant direct costs, and diverts management from core business activities. Small businesses are often disproportionately affected, lacking the resources to dedicate to such activities. While compliance costs are not the only costs that regulation imposes on business, or the wider community, the Government has recognised that they deserve particular attention.

## 1.2 Ensuring regulatory quality

The Australian Government has made a commitment to improve the quality of its regulation and to reduce the burden of regulation on the community.[2] Like most member governments of the Organisation for Economic Cooperation and Development (OECD), it has adopted explicit policies to improve regulatory quality (see box 1.1).

A sound regulation-making process and culture will require ongoing improvements to the way regulation is considered, made and administered.

In 2006 the Government endorsed the following six principles of good regulatory process identified by the Taskforce on Reducing Regulatory Burdens on Business.[2]

- Governments should not act to address 'problems' until a case for action has been clearly established.
  - This should include establishing the nature of the problem and why actions additional to existing measures are needed, recognising that not all 'problems' will justify (additional) government action.
- A range of feasible policy options (including self-regulatory and co-regulatory approaches) need to be identified and their benefits and costs (including compliance costs) assessed within an appropriate framework.
- Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.

[2] *Rethinking Regulation: Australian Government Response*, 15 August 2006.

- Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements.
- Mechanisms are needed to ensure that regulation remains relevant and effective over time.
- There needs to be effective consultation with regulated parties at all stages of the regulatory cycle.

Box 1.1 **OECD focus on regulatory governance**

Across OECD countries, regulatory policy aims to improve the quality of the regulatory environment. What began in the 1980s and 1990s as 'deregulation' evolved into a focus on regulatory reform — encompassing a mixture of deregulation, re-regulation and initiatives to improve the effectiveness of regulatory instruments. These approaches to improving the quality of regulations are, in turn, evolving into a wider notion of 'regulatory governance', embracing wider issues of transparency, accountability, efficiency, adaptability and coherence.

Regulatory governance is based around three supporting elements: explicit regulatory policies that signal commitment to reform and aid transparency; regulatory tools to assist in the review of existing regulation, and the design and development of new regulations; and independent regulatory institutions that operate at arm's length from decision makers and their advisers.

Major tools identified by the OECD to improve the efficiency and effectiveness of regulation include the use of regulatory impact analysis (incorporating competition assessments), the systematic consideration of alternatives, wide public consultation, and improved accountability arrangements in the review of existing regulations and development of new ones.

The Australian Government has integrated these approaches into its regulatory policy development processes through the regulatory impact analysis process — Regulation Impact Statements and compliance cost assessments. Regulatory impact analysis is also widely used by most state and territory governments and most member countries of the OECD.

*Source*: OECD 2002, *Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance*, OECD Reviews of Regulatory Reform, OECD, Paris.

## 1.3 Effective consultation is fundamental

Consistent with the last principle for good regulatory process outlined above, the Australian Government has made a commitment to improving mechanisms for consultation with business and supporting appropriate consultation with all relevant stakeholders.[3] Consultation ensures that both the regulator and the regulated have a good understanding of the problem, alternative options to address it, potential administrative and compliance mechanisms, and associated benefits, costs and risks. Lack of consultation can lead to regulation that is inappropriate to the circumstances, costly to comply with and poorly adhered to.

In 2006 the Australian Government adopted a whole-of-government policy on consultation, which sets out best practice principles that need to be followed by all agencies when developing regulation. This policy contains seven principles for best practice consultation (see part 4 for more details).

**Continuity** — Consultation should be a continuous process that starts early in the policy development process.

**Targeting** — Consultation should be widely based to ensure it captures the diversity of stakeholders affected by the proposed changes. This includes state, territory and local governments, as appropriate, and relevant Australian Government departments and agencies.

**Appropriate timeliness** — Consultation should start when policy objectives and options are being identified. Throughout the consultation process, stakeholders should be given sufficient time to provide considered responses.

**Accessibility** — Stakeholder groups should be informed of proposed consultation and be provided with information about proposals through a range of means appropriate to these groups.

**Transparency** — Policy agencies need to explain clearly the objectives of the consultation process and the regulation policy framework within which consultations will take place, and provide feedback on how they have taken consultation responses into consideration.

**Consistency and flexibility** — Consistent consultation procedures can make it easier for stakeholders to participate. However, this must be balanced with the need for consultation arrangements to be designed to suit the circumstances of the particular proposal under consideration.

**Evaluation and review** — Policy agencies should evaluate consultation processes and continue to examine ways of making them more effective.

[3] *Rethinking Regulation: Australian Government Response*, 15 August 2006.

Related to this whole-of-government consultation policy are three specific consultation mechanisms — Annual Regulatory Plans, a business consultation website, and the requirement for policy 'green papers' and exposure drafts (see part 4 for more information).

The consultation policy is to be applied to all major initiatives and covers all aspects of developing regulation — from the policy proposals/'ideas' stage through to post-implementation reviews. The nature and extent of consultation should be commensurate with the potential magnitude of the problem and the impact of proposed regulatory and non-regulatory solutions.

Consultation requirements are discussed in part 4.

## 1.4 Government's objectives in regulatory assessment

The objectives of the Australian Government in implementing the principles of good regulatory process and consultation are to:

- achieve a robust system of regulatory oversight that encourages sound policy development and implementation by ensuring officials and ministers consider the potential costs and adverse implications, as well as the benefits, of regulatory proposals;
- ensure the Government maintains appropriate control over decision-making processes and the capacity to implement policy quickly where necessary; and
- ensure that ultimate responsibility for regulatory quality rests with individual ministers, departments and agencies, boards, statutory authorities and regulators.

The Government has introduced a range of initiatives to improve the policy development process. These include the use of rigorous cost-benefit analysis (qualitative and quantitative) and, where appropriate, risk analysis in RISs; the assessment of compliance costs; and strengthened gate-keeping arrangements.

It has also established the Office of Best Practice Regulation (OBPR) to provide a one-stop-shop to assist departments and agencies in delivering the Government's best practice regulation requirements.

The OBPR has a number of roles (see box 1.2), including assisting and training departments and agencies to quantify compliance costs and prepare RISs; monitoring and reporting on compliance with the Government's regulation impact analysis requirements; promoting consultation; reporting on regulatory developments; and administering the Council of Australian Governments (COAG) guidelines for regulation making by national bodies.

Box 1.2 **Charter for the Office of Best Practice Regulation**

The role of the OBPR is to promote the Australian Government's objective of effective and efficient legislation and regulations. Its functions are to:

- advise Government departments and agencies on appropriate quality control mechanisms for the development of regulatory proposals and the review of existing regulations;
- examine Regulation Impact Statements and advise whether they meet the Government's requirements and provide an adequate level of analysis, including cost-benefit and risk analysis of appropriate quality;
- advise departments and agencies on the Government's requirements for compliance cost assessments, and maintain the Business Cost Calculator (BCC) as a regulation costing tool;
- manage other regulatory mechanisms, including Annual Regulatory Plans and Regulatory Performance Indicators;
- promote the whole-of-government consultation principles and provide clear guidance on best practice consultation with stakeholders to be undertaken as part of the policy development process;
- provide training and guidance to officials to assist them in meeting the assessment requirements to justify regulatory proposals;
- provide technical assistance to officials on cost-benefit analysis and consultation processes;
- report annually on compliance with the Government's requirements for Regulation Impact Statements, compliance cost assessment and consultation, and on regulatory reform developments generally;
- provide advice to ministerial councils and national standard-setting bodies on Council of Australian Governments guidelines that apply when such bodies make regulations;
- monitor regulatory reform developments in the states and territories, and in other countries, in order to assess their relevance to Australia; and
- lodge submissions and publish reports on regulatory issues that have significant implications.

The OBPR is to focus its efforts on regulations that restrict competition, have a significant impact on business and individuals, or involve medium compliance costs. It is to ensure that effects of proposed new and amended legislation and regulations on small business are made explicit and given adequate consideration.

## 1.5 This Handbook

The *Best Practice Regulation Handbook* sets out the Australian Government's requirements. Compliance with the outlined procedures and processes is *mandatory* for all Australian Government departments, agencies, statutory authorities and boards that make, review or reform regulations.

The Handbook comprises six parts and five appendixes:

- part 2 outlines the Australian Government's best practice regulation requirements and should be read by officials who require a broad understanding of these requirements;
- part 3 provides information on the requirements for regulation making (including preliminary assessments, quantification of compliance costs, preparation of RISs and post-implementation reviews) and should be read by policy officers responsible for preparing regulatory proposals;
- part 4 details the Government's consultation requirements;
- part 5 outlines the key elements of a RIS and the adequacy criteria that need to be satisfied;
- part 6 provides a more detailed discussion of what should be included in a RIS and should be read by policy officers who need to prepare a RIS.

Additional explanatory material is provided in the appendixes. There is also more information at www.obpr.gov.au, including the *preliminary assessment form*, *Users Guide* and *Quickstart to Regulatory Impact Analysis*.

The Council of Australian Governments (COAG) has similar requirements for regulatory impact analysis in place for agreements or decisions of a regulatory nature made by ministerial councils and national standard-setting bodies. These requirements are set down in the COAG-endorsed *Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies* (available at www.obpr.gov.au). Officials engaged in developing proposals for these decision-making forums should refer to that publication, and consult the OBPR early in the policy development process.

# 2 Roles and responsibilities

In order to assist in achieving the Government's objective of improving regulatory quality, there are a number of processes that must be followed in the making, reviewing and monitoring of regulation.

As the bodies responsible for making and, to a large extent reviewing, regulation, departments and agencies have the most direct influence on the quality of regulation. As a result, many of the procedures mandated by Government impact on departments and agencies, and they have an obligation to comply with the requirements set out in this Handbook.

The OBPR has a key role in implementing the Government's best practice regulation requirements.

This part outlines the various roles and responsibilities of departments and agencies in complying with the requirements and of the OBPR, which administers the requirements.

## 2.1 Role of departments and agencies

Departments and agencies and individual ministers are responsible for applying the Australian Government's best practice regulation requirements.

Each Australian Government department and agency has appointed a senior executive officer to champion sound policy development processes. These Best Practice Regulation Coordinators are responsible for administering the Government's framework at a departmental or agency level, and help ensure compliance with the Government's guidelines. The OBPR works closely with Best Practice Regulation Coordinators to facilitate compliance with the Government's regulatory assessment and consultation requirements.

This section outlines these responsibilities. In many cases, the responsibilities are expanded upon in subsequent parts of this Handbook. In other cases, additional information is available from the OBPR.

## Introducing and amending regulation

When introducing or amending regulation, departments and agencies must meet a number of requirements aimed at ensuring that any regulatory change is warranted, and that any costs imposed on business and individuals or the economy are justified.

These obligations, which are detailed in part 3 of this Handbook, require:

- a preliminary assessment of the likely impacts of the regulation to determine whether the regulatory proposal warrants further analysis;
- the quantification of business compliance costs and/or preparation of a Regulation Impact Statement (RIS), (as directed by the OBPR) where the likely impacts are not no/low; and
- where exceptional circumstances are granted by the Prime Minister, the preparation of a post-implementation review within one to two years of implementation.

For proposals considered by Cabinet, where compliance costs have been quantified or a RIS prepared, the regulatory impacts section of the coversheet of the Cabinet submission or memoranda should show 'yes'. Further, departments and agencies should ensure that the compliance cost assessment or RIS is circulated with the Cabinet documentation.

For all other proposals, departments and agencies should ensure that the compliance cost assessment or RIS is provided to the decision maker prior to the decision to proceed with a particular policy option being made.

See part 3 for more information about the Government's requirements relating to introducing and amending regulation.

## Annual Regulatory Plans

Departments and agencies responsible for regulatory changes that may impact on business and individuals or the economy are required to prepare and publish an Annual Regulatory Plan in July each year. These plans provide business and the community with information about planned changes to Australian Government regulation, and make it easier for business to take part in the development of regulation that is likely to affect them.

It is up to individual departments and agencies to manage the coordination and publication of Annual Regulatory Plans within their portfolio. See part 4 for more information on Annual Regulatory Plans.

## Five-yearly reviews

The Government's best practice regulation requirements provide that regulation (not subject to sunset or other statutory review provisions) be reviewed every five years.

A screening process will be used to identify those regulations that should be reviewed. Each year (commencing in 2012 when the first of these reviews will be required), departments and agencies will be sent a list of all regulations made five years previously. Departments and agencies will be required to determine which regulations on the list should be reviewed and how that review should take place. This should take into account the nature of the regulation and its perceived performance.

Departments and agencies will communicate their review schedule (all regulation subject to review in the upcoming year) and strategies in their Annual Regulatory Plan. Where departments and agencies have decided not to review a particular regulation, this should be stated in the Annual Regulatory Plan, along with an explanation as to why no review is being undertaken.

## Reporting to the OBPR

The OBPR has a role in reporting on compliance with the Government's best practice regulation requirements and regulations made each year. To assist in this process, departments and agencies are requested to provide certain information to the OBPR.

Every six months, departments and agencies are required to provide:

- a list of all new and amended regulations made, including whether:
  - preliminary assessments were undertaken;
  - compliance costs were quantified using the Business Cost Calculator (BCC) or an approved equivalent; and
  - an adequate RIS was prepared;
- for matters of major significance (determined by the OBPR), agencies are to report if an initial policy green paper was made available to relevant parties;
- for complex regulations, a report on whether they were tested with relevant business interests, including through exposure drafts;
- a list of all new and amended regulation granted 'exceptional circumstances' by the Prime Minister;
- a list of all post-implementation reviews undertaken; and

- a list of all five-yearly reviews undertaken (beginning in 2012).

The information is required for all types of regulation, including Bills introduced to Parliament; legislative instruments and treaties tabled in Parliament; and non-legislative instruments (including quasi-regulation) made.

## 2.2 Role of the Office of Best Practice Regulation

The OBPR has been assigned a central role in improving the quality of regulation by administering the Government's best practice regulation requirements.

The OBPR has a dual role of assisting departments and agencies in meeting the requirements, and in monitoring and reporting on compliance with the requirements.

The specific roles of the OBPR in the development of regulation, consultation, reviewing regulation and monitoring and reporting are outlined in this section.

### Training and technical advice

The OBPR conducts training programs to assist departments and agencies to prepare RISs, use the BCC to assess compliance costs, and fulfil other regulatory review and reform obligations. The OBPR also provides technical assistance and training to policy officers on cost-benefit analysis and risk analysis.

### Regulatory impact analysis

Where departments and agencies introduce or amend regulation, the OBPR has a role in advising the level of analysis required, and in assisting departments and agencies to quantify compliance costs and prepare RISs.

When contacted by a department or agency, the OBPR will work with the agency to gain an understanding of the proposal, and will advise whether compliance costs should be quantified and whether a RIS should be prepared.[1]

Agencies should develop RISs in consultation with the OBPR and send drafts of RISs to the OBPR for comment and advice early in their development.

[1] As discussed in part 3, agencies can self-assess for matters that will clearly have no/low compliance costs, and no/low other impacts on business and individuals or the economy.

When quantifying compliance costs, the OBPR can provide advice and guidance on using the BCC. It can also approve, and provide advice on, other methods for quantifying business compliance costs.

The OBPR has responsibility for assessing the adequacy of RISs against the criteria detailed in part 5. It will advise departments and agencies when a RIS has reached an appropriate level of analysis and the proposal can proceed to the decision maker.

In providing this advice, the OBPR is concerned solely with the standard of analysis in the RIS. The OBPR does not endorse or support particular regulatory options or outcomes, nor is it in a position to verify data used in RISs or BCC reports. Ultimately, it is the responsibility of departments and agencies preparing the regulatory impact analysis to ensure that the analysis and data are correct and robust.

Similarly, the OBPR is responsible for certifying that compliance costs have been quantified, where required, and that the proposal can proceed to the decision maker.

The OBPR will receive all Cabinet submissions and memoranda proposing regulation. In its coordination comments, the OBPR is required to report to Cabinet on compliance with the best practice regulation requirements and on whether the level of analysis in RISs is adequate.

If a proposal is permitted to proceed (either to Cabinet or to another decision maker) without an adequate RIS or quantification of compliance costs, the resulting regulation must be the subject of a post-implementation review within one to two years (see section 3.5). The OBPR monitors, assesses and reports on compliance with this requirement.

## Supporting good consultation

In providing guidance on stakeholder consultation during policy development, the OBPR promotes the Australian Government's whole-of-government principles on consultation. Details about the consultation requirements and the role of the OBPR are in part 4.

## Monitoring and reporting

Each year in its *Best Practice Regulation Report*, the OBPR reports publicly on compliance with the Government's regulation review and reform requirements. This reporting covers all key aspects of the Government's requirements, including:

- assessment of compliance costs (using the BCC or an approved equivalent);
- preparation of RISs;
- post-implementation reviews; and
- five-yearly reviews (from 2012).

The OBPR also reports more broadly on the regulatory environment in Australia, general trends in regulation, emerging pressures for its expansion and bottlenecks in its reduction.

## OBPR role in COAG regulatory process

These requirements and this Handbook are relevant to development of Australian Government proposals. The Council of Australian Governments (COAG) has similar requirements for regulatory impact analysis in place for agreements or decisions of a regulatory nature made by ministerial councils and national standard-setting bodies. These requirements are set down in the COAG-endorsed *Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies* (available at www.obpr.gov.au). Departments and agencies involved in the development of such proposals should consult the COAG guidelines, rather than this Handbook.

# 3 Best practice regulation requirements

The Australian Government has adopted a three-tiered system for assessing all regulatory and quasi-regulatory proposals.

To determine which level of analysis is appropriate, a preliminary assessment must be undertaken for *all* regulatory proposals.

- For proposals that will have *no or low* impacts on business and individuals or the economy (including no or low compliance costs), no additional regulatory analysis or documentation is required.
- For proposals that are likely to involve *medium* business compliance costs, a full (quantitative) assessment of the compliance cost implications must be carried out using the Business Cost Calculator (BCC) or an approved equivalent.
- For proposals that are likely to have a *significant* impact on business and individuals or the economy (whether in the form of compliance costs or other impacts), a more detailed analysis must be undertaken and documented in a Regulation Impact Statement (RIS). If the impacts include medium or significant business compliance costs, the RIS should include a full (quantitative) assessment of these costs using the BCC or an approved equivalent.

## Proposals subject to the Government's best practice regulation requirements

The requirements apply to:

- proposals with regulatory or quasi-regulatory obligations being brought to Cabinet by ministers;
- letters with regulatory or quasi-regulatory obligations being referred to the Prime Minister by ministers for approval;
- proposals with regulatory or quasi-regulatory obligations of ministers, boards, statutory authorities and regulators; and
- treaties such as conventions, protocols, covenants, charters, agreements, pacts or exchanges of letters with regulatory aspects, or that may result in regulation.

The Government's best practice requirements for regulation apply to *all* government entities that review or make regulations that have an impact on business and individuals or the economy. This includes agencies or boards with administrative or statutory independence.

The Government considers impact analysis of regulatory proposals to be best practice, and encourages departments and agencies to consider the impact proposals may have on business and individuals. To this end, the Government encourages early contact with the OBPR to assess whether a proposal falls within the scope of the regulatory framework.

The term 'regulation' includes proposals given effect by both primary and subordinate legislation, as well as by quasi-regulation. 'Quasi-regulation' refers to a wide range of rules or arrangements where governments influence businesses and individuals to comply, but which do not form part of explicit government regulation (see box 3.1).

Changes to primary and subordinate legislation are regulatory if they impose any obligation on business or the community, or affect the environment in which stakeholders operate. Most legislative changes have some implications for stakeholders. However, some legislation is not regulatory, for example, where it affects only internal government processes, and not the regulatory environment for non-government stakeholders.

If an initial examination shows that a proposal to amend legislation is not regulatory in nature, it is not necessary to undertake a formal preliminary assessment.

'Business' includes any private organisation that aims to make a profit (including sole traders), the commercial activities/transactions of non-profit organisations, and any government business enterprise.

## 3.1 Preliminary regulatory impact analysis

The *Users Guide* provides an overview of the initial steps policy officers should follow to comply with the Government's requirements. This section of the Handbook provides more guidance.

### Step 1: Analyse the problem — is regulation being considered?

In considering a response to an issue, policy officers should examine the problem, identify the Government's objectives and consider all feasible options.

Box 3.1 **What is quasi-regulation?**

As well as establishing regulation explicitly through legislation, governments also achieve regulatory ends by putting pressure on businesses to comply with rules that may not be legally binding. These types of arrangements are referred to as 'quasi-regulation'.

The Government's regulatory impact assessment requirements have specifically applied to quasi-regulation that affects business since 1998. Under current arrangements, all proposals with regulatory or quasi-regulatory obligations must undergo a preliminary assessment to establish whether they are likely to involve an impact on business and individuals or the economy.

Quasi-regulation includes a wide range of rules or arrangements where governments influence businesses and individuals to comply, but which do not form part of explicit government regulation. Broadly, whenever the Government takes action that puts pressure on businesses to act in a particular way, the Government action may be quasi-regulatory.

In determining whether a proposal is quasi-regulatory in nature, the department or agency should consider factors that would suggest a proposal is quasi-regulatory, such as whether the proposal imposes requirements:

- that apply to all individuals or businesses, or to a class of individuals or businesses;
- that impose an obligation on those the proposal applies to; or
- provide for a sanction (or negative impact) as a consequence of non-compliance.

The Government considers impact analysis of regulatory proposals to be best practice, and encourages departments and agencies to consider the impact proposals may have on business and individuals. To this end, the Government encourages early contact with the OBPR to assess whether a proposal falls within the scope of the regulatory framework.

In specifying the problem or issue that has prompted a consideration of government action, the policy officer should address some key questions. What is the problem being addressed? How significant is it? Why is government action needed to correct the problem? Is there relevant regulation already in place? If so, why is additional action needed? Section 6.1 provides more information on how to address these questions.

The policy officer should also identify what objectives, outcomes, goals or targets are sought in relation to the identified problem (see section 6.2 for more guidance).

Once the policy officer has examined the problem and established a case for government intervention, consideration should be given to all feasible options (non-regulatory and regulatory) that could wholly or partly achieve the Government's

objective. Alternative regulatory forms, including self-regulation, quasi-regulation, co-regulation and 'black letter law', are discussed in section 6.3 and appendix A.

If only non-regulatory options are being considered, no further regulatory analysis is required. However, if a regulatory option is being considered, a preliminary analysis of the likely impacts is required (see step 2).

## Step 2: Undertake a preliminary assessment

As noted above, the Government has mandated a three-tier system for assessing regulation, including:

- limited analysis for proposals that will have no or low impacts;
- quantification of compliance costs (using the BCC or an approved equivalent) for proposals that will entail medium business compliance costs; and
- in-depth analysis, documented in a Regulation Impact Statement (RIS), for all proposals that will have a significant impact on business and individuals or the economy.

The preliminary assessment will assist in determining whether any further analysis is required. It requires an assessment of the compliance costs likely to be involved with a proposal, as well as an assessment of the other impacts (including competition impacts).

To assist in this process, a preliminary assessment form is available from the OBPR website (www.obpr.gov.au).

### *Assessing business compliance costs*

Compliance costs are the direct costs to businesses of performing the various tasks associated with complying with government regulation (see box 3.2).

For proposals that will have no or low compliance costs (and other impacts are also assessed to be no/low — see next section), no further action is required and officers may self-assess (see explanation of self-assessment below). If compliance costs are likely to be higher, or if you are unsure, contact the OBPR.

Box 3.2 **Business Compliance Cost Checklist**

As part of a regulatory impact assessment, a practical approach for considering the impacts on business compliance costs potentially flowing from regulatory proposals is through a set of threshold questions (a compliance cost checklist).

Would the regulatory proposal involve one of the following compliance tasks?

**Notification**

Will businesses incur costs when they are required to report certain events?

– For example, businesses may be required to notify a public authority before they are permitted to sell food.

**Education**

Will businesses incur costs in keeping abreast of regulatory requirements?

– For example, businesses may be required to obtain the details of new legislation and communicate the new requirements to staff.

**Permission**

Are costs incurred in seeking permission to conduct an activity?

– For example, businesses may be required to conduct a police check before legally being able to employ staff.

**Purchase cost**

Are businesses required to purchase materials or equipment?

– For example, businesses may be required to have a fire extinguisher on-site.

**Record keeping**

Are businesses required to keep records up to date?

– For example, businesses may be required to keep records of accidents that occur at the workplace.

**Enforcement**

Will businesses incur costs when cooperating with audits or inspections?

– For example, businesses may have to bear the costs of supervising government inspectors on-site during checks of compliance with non-smoking laws.

**Publication and documentation**

Will businesses incur costs when producing documents for third parties?

– For example, businesses may be required to display warning signs around dangerous equipment, or to display a sign at the entrance to home-based business premises.

**Procedural**

Will businesses incur non-administrative costs?

– For example, businesses may be required to conduct a fire safety drill several times a year.

**Other**

Are there any other compliance costs (including indirect costs or impacts on intermediaries such as accountants, lawyers, banks or financial advisers) associated with the regulatory proposal?

In general, compliance costs to business would be low if only a few businesses are affected and the costs are negligible or trivial, for example:

- changes to regulation that are machinery in nature, involving technical changes that will not have an appreciable impact on business and are consistent with existing policy;
- there would be a very small initial one-off cost to business and no ongoing costs; and
- businesses would not need to seek advice about the change from external advisers.

Proposals that have a broad impact (that is, affect a large number of businesses), or involve a cost per business that is not negligible (in relation to the size of businesses involved), generally would not be considered to generate low compliance cost impacts. In such cases, departments and agencies should contact the OBPR, which will determine the level of regulatory impact analysis required.

The business compliance costs of an individual regulation include only the incremental or additional costs that arise from that proposal. They do not include costs of activities that would have been carried out anyway (that is, before the regulation was in place or as part of normal business practice).

While the compliance costs associated with a single regulation may be small, the cumulative burden on businesses of complying with regulations can be substantial. The burden of compliance costs tends to fall more heavily on smaller businesses. For example, the costs of identifying and understanding the obligations imposed by a new regulation are likely to form a significantly larger proportion of a small business's total costs compared with a larger business. They are also more likely to occupy the owner or manager of the business, rather than be delegated, as in a larger firm. Furthermore, many in small businesses struggle to understand and comply with all the regulations applying to them, thus creating an environment of regulatory uncertainty and risk. Where a RIS is required, impacts on small business should be separately identified (see part 6).

### *Assessing the other impacts on business and individuals or the economy*

The second part of determining whether further analysis is required is an assessment of any other impacts on business and individuals or the economy (including restrictions on competition). The 'Other impacts' checklist (see box 3.3) can help identify such impacts.

Box 3.3 **'Other impacts' Checklist**

As part of a regulatory impact assessment, a practical approach for considering the impacts potentially flowing from regulatory proposals is through a set of threshold questions.

The following checklist will help assess whether a proposal has a potential impact on business and individuals or the economy. Will the proposal:

- Potentially affect the number and range of businesses in an industry?
  - For example: - change the ability of businesses to provide a good or service;
  - change the requirement for a licence, permit or authorisation process as a condition of operation;
  - affect the ability of some types of firms to participate in public procurement;
  - significantly alter costs of entry to, or exit from, an industry; or
  - change geographic barriers for businesses.
- Potentially change the ability of businesses to compete?
  - For example: - control or substantially influence the price at which a good or service is sold;
  - alter the ability of businesses to advertise or market their products;
  - set significantly different standards for product/service quality; or
  - significantly alter the competitiveness of some industry sectors.
- Potentially alter the incentives for business to compete?
  - For example: - create a self-regulatory or co-regulatory regime;
  - impact on the mobility of customers between businesses;
  - require/encourage the publishing of data on company outputs/price, sales/cost; or
  - exempt an activity from general competition law.
- Potentially impact on consumers?
  - For example: - alter the choices available to consumers;
  - affect the quality of consumer products or services;
  - create or remove restrictions on access to a product;
  - promote or restrict information dissemination to consumers; or
  - add to or reduce the complexity of consumer products or services.
- Potentially have any other impacts on business and individuals or the economy?
  - For example: - mandate payments from one party to another (excluding taxes);
  - have environmental or social impacts (including distribution of resources);
  - create or amend government cost recovery arrangements;
  - impact on Australia's international capital flows or trade;
  - impact on mobility of labour;
  - impact on resource allocation, saving or investment;
  - transfer risk between business, individuals and government; or
  - impose any other financial costs.

Regulation can require or encourage businesses to alter the way they behave. Consequently, the Government requires that for regulatory proposals that potentially have a significant impact on business and individuals or the economy (including via competition impacts), a detailed analysis should be prepared and documented in a RIS, which is provided to the decision maker and then made public.

This requirement applies to proposals with significant compliance costs and also proposals that significantly affect businesses and individuals in other ways. Low compliance costs may not be sufficient to remove the need for a RIS.

If the impacts of your proposal are greater than 'low', or if you are unsure, contact the OBPR.

Bear in mind that 'other impacts' should be interpreted broadly and include both positive and negative impacts (that is, costs and benefits). They include items that can be immediately quantified in monetary terms (for example, service charges and subsidies) and those that cannot be quantified (for example, restrictions on competition or environmental damage). They include direct and indirect impacts, financial and non-financial impacts, and 'market' and 'non-market' impacts.

Impacts should be assessed from an economy-wide perspective, taking into consideration the number of businesses or individuals affected and the size of the costs and/or benefits to those businesses or individuals. Information and data collection, together with consultation with key stakeholders, can help in making a crude estimate of the likely impacts.

### *Self-assessment*

After examining the likely compliance cost implications and other impacts on business and individuals, officers can self-assess when the proposal will have no or low compliance costs and no or low other impacts on business and individuals or the economy. If the proposal does not meet these criteria, or if you are uncertain, contact the OBPR.

To self-assess (that a regulatory proposal will have no or low impacts), policy officers should provide a description of the proposal and record the reasons for believing that there will be no or low impacts on business and individuals. The preliminary assessment form (available from the OBPR website at www.obpr.gov.au) may assist with this process. Documentation recording the description of the proposal and reasons for believing that there will be no/low impacts should be provided to the Best Practice Regulation Coordinator in the policy officer's department or agency. The Coordinator will keep a record of all preliminary assessments undertaken.

Policy officers should be aware that the final decision on whether further analysis is required rests with the OBPR. If a proposal is self-assessed as having no or low impacts when in fact the impacts will be more significant, the department or agency may be non-compliant with the Government's best practice requirements (see section 3.5).

Policy officers should continue to monitor changes to the proposal prior to implementation. If, at some point, a change is made that would increase the level of the likely impacts such that they were no longer low, the policy officer should contact the OBPR.

### Step 3: Consult with the OBPR and determine further action

If the impacts of a proposal are not 'no or low', or if the policy officer is unsure, they should consult the OBPR.

The OBPR will work with the department or agency to gain a mutual understanding of the proposal. The OBPR may advise that more information is required, or it may determine that:

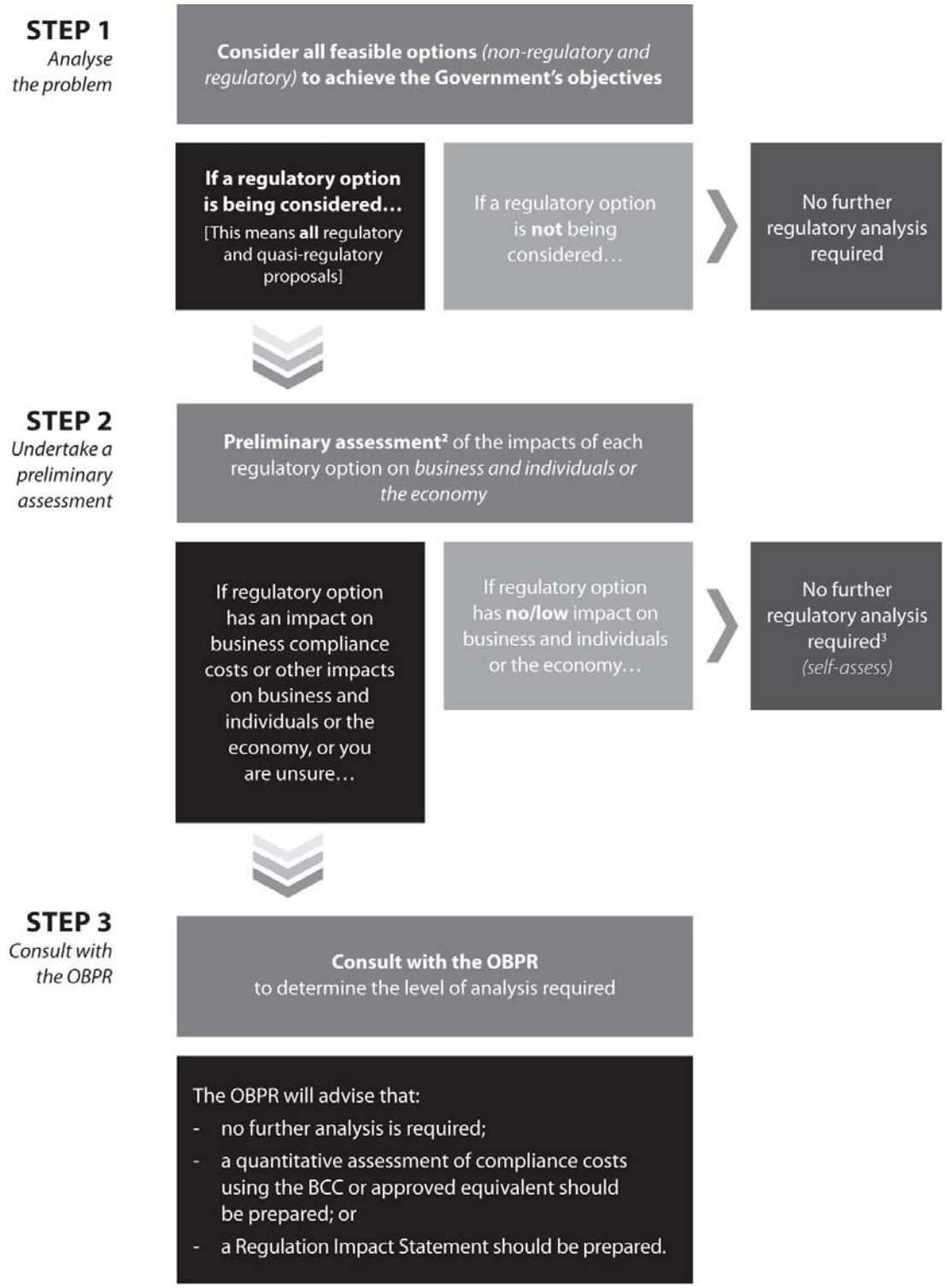
- the likely impacts of the proposal will be 'no or low' and no further analysis is required;
- the compliance costs will be medium (and other impacts 'no or low') and the department or agency should quantify compliance costs using the BCC or an approved equivalent (see next section); or
- the proposal will have significant impacts on business and individuals or the economy, and the department or agency should prepare a RIS, which may be required to include a quantitative assessment of business compliance costs (see section 3.3 and parts 5 and 6).

The OBPR will also advise if the matter is highly significant and an initial policy green paper should be made available to relevant parties (see part 4).

In determining whether a proposal is likely to entail low, medium or significant impacts (either through compliance costs or other impacts), the OBPR will consider a number of factors, including the nature of the proposal, as well as the number and size of the businesses and individuals affected.

In terms of the nature of proposals, a ban on popular or widespread activities would generally be regarded as highly significant. Placing conditions on activities, such as requiring licences or specific standards, would be regarded as a significant intervention. An example of low significance might be a change in the format of reporting requirements for businesses.

Figure 3.1 **Preliminary regulatory impact analysis**[1]




1. These procedures and processes are mandatory and apply to all government entities that review or make regulations that have an impact on business and individuals or the economy.
2. A preliminary assessment form is available from the OBPR website (www.obpr.gov.au).
3. Record the reasons why you decided there are likely to be no or low impacts and report these to your Best Practice Regulation Coordinator.

The OBPR examines whether the potential impacts will be broad (and impact on a large number of businesses and individuals) or narrow. An increase in the rate of excise on petrol, for example, would be considered broad in its impact. On the other hand, a late night curfew on flights into a regional airport would be relatively narrow in terms of its impacts. A third example might be deregulation of the dairy industry. While there might be a relatively narrow costly impact for the dairy industry, for consumers there might be a widely dispersed, minor impact which could result in the proposal being classified as 'broad'. Many regulatory proposals have both direct and indirect effects.

The OBPR also looks at the size and type of the businesses affected. A relatively small financial impact on a large corporation may not be seen as significant. But an equivalent-sized financial impact on a small business would be seen as more significant as it would have a larger impact on its ability to undertake its business.

## 3.2 Compliance cost analysis requirements

If the OBPR indicates that the proposal is likely to involve a medium compliance burden for business, policy officers are required to quantify compliance costs using the BCC or an approved equivalent. Where a RIS is required, the quantification of compliance costs forms part of the RIS requirements.

The BCC is a software package to be used for quantitative analysis of compliance costs. Policy officers can use other methods provided they will give a robust estimation of compliance costs and the policy officer seeks prior approval from the OBPR.

Information on the BCC is provided in box 3.4 and appendix D. The software for this IT-based tool and instructions on how to use it are available from the OBPR website (www.obpr.gov.au). The website includes guidance material and video tutorials. If you require assistance, contact the OBPR.

Once compliance costs have been quantified, the BCC report (a report generated by the BCC) should be used to provide an estimate of compliance costs to decision makers. Prior to policy approval being sought, the BCC report should be provided to the OBPR to confirm that the quantification requirements have been met.

Box 3.4 **What is the Business Cost Calculator?**

The BCC is an IT-based tool designed to assist policy officers in estimating the business compliance costs of various policy options. It provides an automated and standard process for quantifying compliance costs of regulation on business using an activity-based costing methodology.

Compliance costs are defined as the direct costs to businesses of performing the various tasks associated with complying with government regulation. The BCC has nine categories of compliance tasks for which compliance costs are incurred by business (see box 3.2).

As a first step, you are asked to provide a description of the problem and the potential policy options for addressing that problem.

The *Quickscan* function of the BCC is then used to indicate whether or not any of the proposed options will impose compliance costs in any of the nine cost categories.

Where users indicate that at least some options will involve compliance costs, the calculator then assists in quantifying these costs. You are asked to detail:

- the number of businesses affected by each option;
- the tasks that business will have to complete to be compliant with the regulation;
- whether the task is an internal cost or an outsourced cost;
- whether the task is a start-up or ongoing cost;
- how long each task will take to complete;
- how often each task will need to be undertaken;
- the associated labour and other costs; and
- supporting evidence for all information.

From this information, the BCC will provide an estimate of the compliance costs associated with each option.

The BCC data can be displayed, printed and downloaded to other applications in a range of reports. A key report is the 'BCC report', which should be provided to the OBPR to confirm that the best practice regulation requirements have been met. It is this report that is sent to the decision maker and made public.

For additional information about the BCC, see appendix D.

The compliance cost impacts of taxation measures are assessed using a tax specific compliance cost calculator (the Tax CCC). The Tax CCC has been approved for use in calculating business compliance costs and can be used to undertake quantitative analysis of the compliance cost impacts of taxation measures. Where the Tax CCC is used to quantify compliance costs, a copy of the Tax CCC Summary Report

should be provided to the OBPR to certify that the quantification requirements have been met.

Where officers are not using the BCC to quantify compliance costs, they should prepare an equivalent report that details:

- the upfront (or start-up) compliance costs of the proposal;
- the ongoing (or yearly) compliance costs of the proposal; and
- all assumptions and data sources used in generating these estimates.

Again, this report must be provided to the OBPR prior to policy approval being sought to ensure that the best practice regulation requirements have been met.

## 3.3 Regulation Impact Statement requirements

As noted above, a RIS is required when there are significant impacts on business and individuals or the economy. This section provides a brief introduction to RISs and the differing requirements for restrictions on competition and treaties. Parts 5 and 6 contain more detail and advice about preparing RISs.

### What is a Regulation Impact Statement?

A RIS is a document prepared by the department, agency, statutory authority or board responsible for a regulatory proposal, following consultation with affected parties. It formalises and provides evidence of the key steps taken as part of a good policy development process. It includes an assessment of the costs and benefits of each option, followed by a recommendation supporting the most effective and efficient option.

Preparation of a RIS ensures that all relevant information is documented, and that the decision-making processes are made explicit and transparent.

A RIS has seven elements, setting out:

- the problem or issues that give rise to the need for action;
- the desired objectives;
- the options (regulatory and/or non-regulatory) that may constitute viable means for achieving the desired objectives;
- an assessment of the impact (costs, benefits and, where relevant, levels of risk) on consumers, business, government and the community of each option;

- a consultation statement;
- a recommended option; and
- a strategy to implement and review the preferred option.

All seven elements of a RIS should contain a degree of detail and depth of analysis that is commensurate with the magnitude of the problem and the size of the potential impacts of the proposal (see part 5).

There is no fixed length for a RIS. However, as for policy advice, the emphasis is on *quality* rather than quantity. While the RIS should be a stand-alone document, technical or detailed supporting material could be placed on the sponsoring agency's website and cross-referenced in the RIS. As a rough guide, a RIS for a simple straightforward proposal might be six to eight pages. Even for a highly complex proposal, a RIS could be less than 35 pages.

There are a number of additional elements that may be required in a RIS, depending on the nature of the proposal.

### *Requirements for tax proposals*

In some instances, the full regulatory impact assessment process may be inappropriate for taxation proposals. For instance, prior consultation on tax measures could release sensitive information and may be used by tax payers to engage in tax avoidance or minimisation schemes. Similarly, many tax measures are developed as part of the budget process and prior consultation may be inappropriate. In addition, the benefits derived from the collection of revenue can not be attributed to particular taxation measures.

For these reasons, the impact analysis section and consultation sections of a RIS prepared for taxation proposals may be modified. A RIS for tax proposals does not assess the need for revenue collection or the benefits/costs arising from the revenue raised or forgone. Nor does it consider changes in rates of taxation or the mix of different types of taxation where this relates to changes to the tax base. While it is appropriate to look at the need for amending taxation arrangements — the problem should be clearly identified — the RIS would not be expected to question the underlying rationale for the existing taxation measure. Like other regulatory proposals, a RIS for tax proposals should articulate the costs and benefits associated with the alternative options that can feasibly address the identified problem. Where possible, the benefits and costs should be quantified. Where the objective of the tax proposal could also be achieved through options other than changes to the tax system, the RIS should examine such options. For sensitive proposals, such as changes in specific tax rates or thresholds, the RIS for publication may be modified

after the decision-maker's consideration (in consultation with the OBPR) to focus on the impacts of the implementation option. Where consultation is limited the RIS needs to note the reasons why full consultation was inappropriate. Where consultation will occur after the initial decision is made, the RIS should identify what consultation will be undertaken. The RIS may be updated after consultation has occurred and before any subsequent decision-making stages.

### *Requirements for restrictions on competition*

Restrictions on competition include regulations that might limit the number or range of suppliers, limit their ability to compete, or reduce their incentives to compete (see box 3.5). They may also directly limit consumer choice. Restrictions on competition can impose substantial costs through higher prices, reduced choice and impediments to innovation and efficiency. Reflecting these costs, proposals to introduce restrictions on competition should be analysed in RISs.

Guidance on incorporating competition assessment into the RIS is provided in part 6. However, in short, a RIS can only recommend a restriction on competition where:

- the benefits to the community as a whole outweigh the costs; and
- the Government's objectives can be achieved only by restricting competition.

### *Requirements for treaties*

As noted above, treaties that are likely to involve domestic regulations that will significantly impact on business and individuals or the economy, or impose medium compliance costs, are subject to further analysis under the Government's best practice regulation requirements. While requirements for treaties differ in terms of process (see box 3.6), the requirements of the underlying analysis (in the RIS or BCC report) are no different.

Box 3.5 **Competition Assessment Checklist**

As part of a regulatory impact assessment, a practical approach for considering whether a proposal may restrict competition is through a set of threshold questions (a competition restriction checklist):

- Would the regulatory proposal restrict or reduce the number and range of businesses?

  For example:

– grant exclusive rights for a supplier to provide a good or service;
– establish a licence, permit or authorisation process as a requirement of operation;
– affect the ability of some types of firms to participate in public procurement;
– significantly alter costs of entry or exit to a supplier; or
– create a geographic barrier to the ability of businesses to supply goods or services, invest or supply labour.

- Would the regulatory proposal restrict or reduce the ability of businesses to compete?

  For example:

– control or substantially influence the price at which a good or service is sold;
– alter the ability of suppliers to advertise or market their products;
– set standards for product/service quality that are significantly different from current practice; or
– significantly alter costs of some suppliers relative to others.

- Would the regulatory proposal alter businesses' incentives to compete vigorously?

  For example:

– create a self-regulatory or co-regulatory regime;
– impact on the mobility of customers between suppliers;
– require/encourage the publishing of information on company outputs/price, sales/cost; or
– exempt an activity from general competition law.

If the answer to any of these questions is 'yes', the RIS should specifically address these issues and consider whether the objective of the regulation could be achieved through means that would not restrict competition.

## 3.4 Implementing regulatory impact analysis

The preparation of a RIS or quantification of compliance costs is required for proposals that have more than a low impact (see section 3.1). This section looks at when officers should undertake this analysis and how it should feed into the policy approval process.

### When should regulatory analysis occur?

In order to obtain the maximum benefit from the regulatory impact analysis process, the Australian Government has decided that the RIS or BCC report must be prepared by officials once an administrative decision is made that regulation may be necessary, but *before* a policy decision is made by the Government or its delegated officials that regulation is necessary (see figure 3.2).

The analysis in the BCC report or RIS should feed into decision-making papers such as Cabinet submissions (refer to the *Drafter's Guide: Preparation of Cabinet Submissions and Memoranda*).

Departments, agencies, statutory authorities and boards are required to consult with the OBPR as early as possible in the policy development process, and should develop RISs in consultation with the OBPR.

The analytical framework underpinning a RIS should be used throughout the policy development process. For reviews of existing regulation, the terms of reference should reflect the key elements of the RIS, with any associated reports, studies, reviews, discussion papers or green papers using a RIS (cost-benefit and risk analysis) framework. This requirement ensures that the RIS framework is incorporated at an early stage in regulation reviews and is used until a RIS is prepared, prior to a policy decision being made. While there is no formal requirement to publicly release RISs or BCC reports (or approved equivalents) for consultation, departments and agencies are strongly encouraged to do so.

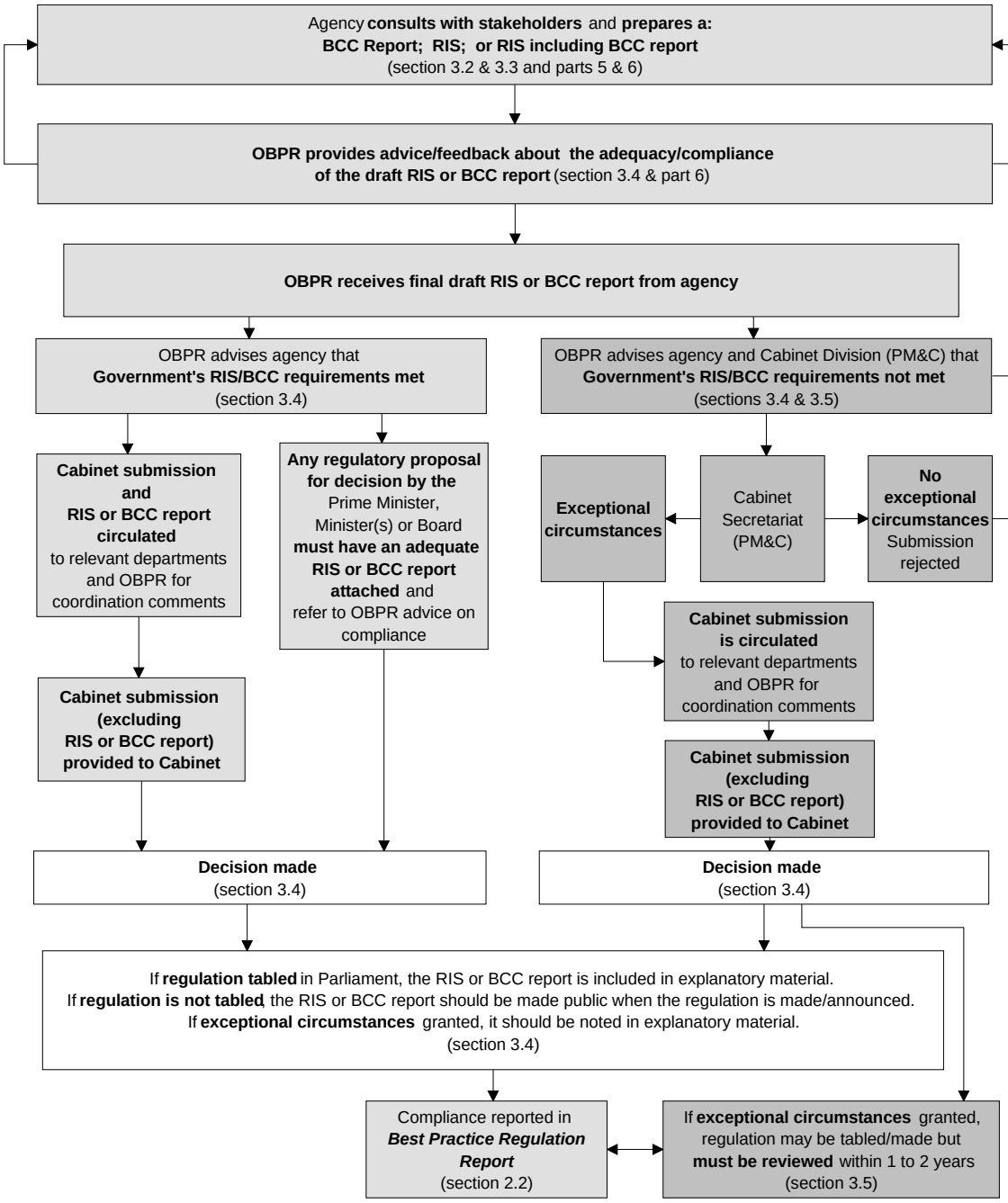
For matters of major significance (see part 4), the Government requires that an initial policy green paper should be made available to relevant parties.

Prior to finalisation, the details of complex regulations should be tested with relevant business and community stakeholder interests, including through exposure drafts.

In the case of treaties that involve regulation, a RIS should be prepared before the formal policy decision to pursue treaty negotiations, again prior to Australia signing a treaty and, finally, when the treaty is tabled in the Parliament with the National

Interest Analysis (see box 3.6 for more information about the RIS requirements for treaties).

## Figure 3.2 Integrating 'best practice processes for regulation' with the policy development process



Box 3.6 **Best practice regulation requirements for treaties**

Treaties that are likely to involve domestic regulation are subject to the Government's best practice regulation requirements. Policy officers should undertake a preliminary assessment and consult with the OBPR (see section 2.2) to determine whether a RIS or quantitative assessment of compliance costs will be required.

The following outlines the regulation requirements for the treaty-making process where the OBPR confirms that a RIS is required:

- When policy approval is sought for the formal commencement of negotiations, the RIS should accompany the Cabinet submission or letter to the Prime Minister, Minister for Foreign Affairs or other relevant ministers. At this early stage, the RIS should focus on the nature of the problem being addressed, the objectives of the proposed treaty and a preliminary discussion of options and their respective costs, benefits and, where appropriate, levels of risk. Where approval is sought from Cabinet, a one-page summary of the RIS should be attached to the submission and the full RIS must be available from the sponsoring minister's department (through that department's Cabinet liaison officer).
- When endorsement is sought to sign the final text of a treaty, the RIS would need to include more detailed cost-benefit analysis that assesses the likely impacts on different groups within the Australian community. Where approval is sought from Cabinet, a one-page summary of the RIS should be attached to the submission and the full RIS must be available from the sponsoring minister's department (through that department's Cabinet liaison officer).
- Where the OBPR confirms that a quantitative assessment of compliance costs is required, it should be prepared prior to signing (it is not required for the entry into negotiations stage) and attached to the letter or submission seeking approval to sign the final text of the treaty.
- As part of the transparency stage, the RIS and/or compliance cost report for the treaty is tabled or made public with the final text of the treaty and National Interest Analysis.

A RIS is not required for domestic legislative changes that are required to implement a treaty if the terms of the treaty determine the action required to implement it. However, if there is any discretion about the nature of the action to be taken to implement the treaty, a RIS may be required for the domestic legislation.

The objective of the best practice regulation requirements is to aid decision-making processes. The RIS and quantification requirements at the tabling stage are additional to the National Interest Analysis requirements.

Details about RISs and treaties are also included in the Department of Foreign Affairs and Trade document, *Signed, Sealed and Delivered. Treaties and Treaty Making: An Officials' Handbook*. More information can also be obtained from the OBPR.

## Implementation at the decision-making stage

The Government has decided that, in the absence of exceptional circumstances as agreed by the Prime Minister, a regulatory proposal with medium compliance costs or significant impacts on business and individuals or the economy (including restrictions on competition) cannot proceed to Cabinet or other decision makers unless it has complied with the Government's regulatory impact analysis requirements.

The OBPR is required to advise decision makers on the adequacy of the RIS or quantification of compliance costs where required. Figure 3.2 illustrates how the Government's regulatory best practice requirements can be integrated into the policy development process at the decision and transparency stages.

### *Proposals considered by Cabinet*

Based on the *Drafter's Guide: Preparation of Cabinet Submissions and Memoranda,* where there is an impact from a regulatory proposal (that is, there are medium compliance costs or significant impacts on business and individuals or the economy), the regulatory impacts section of the summary of the Cabinet submission or memoranda should show 'yes'. Where there are no or low impacts, the regulatory impacts section of the summary section should show 'no'. Where there are regulatory impacts, the submission should then:

- summarise the main impacts in a few lines on the cover sheet;
- provide a short summary paragraph in attachment A to the submission or memorandum (the supporting arguments) under a separate heading 'Regulation Impact Analysis', indicating the regulatory cost of the proposals to business and individuals and the economy and its net benefit to the community, and including an assessment of initial (upfront) compliance costs and ongoing annual costs/savings; and
- at the end of the summary paragraph in attachment A to the submission or memorandum, note that copies of the full RIS or BCC report or approved equivalent are available on request from the sponsoring minister's department (through that department's Cabinet liaison officer).

Where there are compliance cost impacts from a regulatory proposal:

- this should be noted after the heading 'Regulatory compliance cost' (in the *Impacts* section of the summary sheet); and
- an estimate of the total upfront cost and ongoing compliance costs/savings should be provided in a supporting sentence; or

- where the compliance costs are low, this should be stated in a supporting sentence.

The agency should also indicate whether or not the OBPR agrees that the best practice regulation requirements have been met.

Where proposals require the preparation of a RIS or quantification of compliance costs, the RIS or BCC report (or an approved equivalent) should be included in documentation circulated to agencies preparing coordination comments at the time the draft seeking those comments is circulated. Any RIS or BCC reports would be available, but not attached to the final submission or memorandum.

The OBPR will comment on compliance with the Government's regulatory impact analysis requirements and the adequacy of both the summary and the full RIS in its coordination comments.

The Cabinet Secretariat provides a gate-keeping role to ensure that regulatory proposals coming to Cabinet meet regulatory assessment requirements. The Cabinet Secretariat will not circulate final Cabinet submissions or memoranda without adequate RISs or compliance cost assessments unless the Prime Minister has deemed that exceptional circumstances apply (see figure 3.2).

### *Proposals requiring policy approval from the Prime Minister*

Where policy approval is sought from the Prime Minister, the RIS or BCC report (or approved equivalent), and the OBPR's advice about its adequacy, accompanies the letter to the Prime Minister seeking approval. The RIS or BCC report should first be provided to the relevant minister before policy approval is sought from the Prime Minister.

### *Proposals not requiring external policy approval*

Where regulatory action requiring a RIS or BCC report (or approved equivalent) does not need policy approval from outside the portfolio, department or agency, the RIS or BCC report, and the OBPR's advice about its adequacy, should be included in material presented to the decision maker (minister, board or senior official).

## Transparency stage

After policy approval has been given, the final RIS or BCC report, which should be of a standard suitable for publication, is made available to the public.

Where a regulatory proposal is tabled in Parliament, the RIS or BCC report (or approved equivalent) prepared at the decision-making stage must be included in the explanatory memorandum (for primary legislation) or the explanatory statement (for legislative instruments). RISs or BCC reports for treaties will be tabled along with the National Interest Analysis. RISs or BCC reports for other instruments and new or amended quasi-regulation must also be made public.

There is scope for draft RISs and BCC reports to be modified after the decision maker's consideration where, for example, a draft RIS refers to commercial-in-confidence or national security information. However, such changes should be made in consultation with the OBPR.

If exceptional circumstances have been granted by the Prime Minister, it should be noted in the explanatory material. It is a Government requirement that the resulting regulation be the subject of a post-implementation review within one to two years of implementing the proposal (see next section).

## 3.5 Consequences of non-compliance

As noted, the Government has decided that no regulatory proposal should go to Cabinet or any other decision maker unless it has complied with the Government's regulatory impact assessment requirements, as advised by the OBPR.

The Cabinet Secretariat will not circulate final Cabinet submissions or memoranda without adequate RISs or compliance cost assessments unless the Prime Minister has deemed that exceptional circumstances apply (see figure 3.2).

Similarly, a regulatory proposal for decision by the Prime Minister, minister or other decision maker should not go forward to the decision maker unless the OBPR has indicated that the Government's regulatory impact assessment requirements have been satisfied.

### Detecting non-compliance

Each six months, the OBPR will review compliance with the Government's best practice regulation requirements. At the commencement of this period, the OBPR will ask each department and agency to prepare a list of all regulation made during the previous six months (see part 2). The OBPR will review all regulation made to ensure that where further analysis was required (that is, quantification of compliance costs or preparation of a RIS), these requirements have been met.

Where the OBPR detects a regulation may have been introduced or amended without the appropriate level of analysis being undertaken, it will, in the first instance, contact the department or agency to obtain additional information. Following consultation with the department or agency, the OBPR will determine that:

- the best practice regulation requirements have been met and no further action is required; or
- the requirements to prepare a RIS or quantitative assessment of compliance costs have not been met and the department or agency must undertake a post-implementation review. In addition, the department or agency will be reported as non-compliant in the *Best Practice Regulation Report* for that year.

The OBPR reports publicly about compliance with the Government's regulation review and reform requirements in the *Best Practice Regulation Report* and in the Productivity Commission's annual report.

## Post-implementation reviews

Where a proposal proceeds (either through Cabinet or another decision maker) without an adequate RIS or quantification of compliance costs, the resulting regulation must be the subject of a post-implementation review within one to two years of implementation. This post-implementation review will be required regardless of whether or not exceptional circumstances have been granted for the proposal. It should be noted that a post-implementation review is not a substitute for undertaking adequate analysis before a decision is made.

The post-implementation review should focus on the way the policy was implemented, whether the implementation is proving effective in meeting the policy objectives, and whether implementation or ongoing delivery methods might be adjusted to manage the policy's ongoing delivery more efficiently and/or effectively.

The review should be similar in scale and scope to what would have been prepared for the decision-making stage. However, it should be noted that the precise nature of each review will depend on the individual problem and regulations that were put in place to address that problem. Where departments or agencies are unsure of what is required, they should contact the OBPR for more information. However, all post-implementation reviews should:

- identify the objective of government action;

- consider the impacts of the regulation (whether the regulation is meeting its objectives); and
- consider whether the policy objectives could be achieved in a more efficient and effective way.

For regulations that would have required the quantification of compliance costs (that is, regulations with medium-level compliance costs), the post-implementation review will require an estimation of the incurred and ongoing compliance costs.

Agencies are expected to consult with stakeholders when preparing for, or undertaking, a post-implementation review.

Parts 5 and 6 of this Handbook provide guidance on regulatory analysis that may be useful for agencies undertaking a post-implementation review.

Departments and agencies should identify each post-implementation review they are responsible for in their Annual Regulatory Plan. Reviews for jointly sponsored proposals should be included in the Annual Regulatory Plan of each sponsoring department or agency.

The OBPR will monitor the status and adequacy of post-implementation reviews.

# 4 Best practice consultation requirements

## 4.1 Introduction

Consultation is an important part of the best practice regulation requirements. The Government is committed to the need for effective consultation with regulated parties at all stages of the regulatory cycle. There are strong synergies between the regulatory impact analysis and consultation processes. Delivery on both should help improve the quality of new and amended regulation.

It is important to note that the nature of consultation should be commensurate with the magnitude of the problem and the size of the potential impact of the proposal.

This part contains more detail on the application of the whole-of-government consultation principles (outlined in section 1.3). It discusses the Government's requirements for green papers and exposure drafts of regulation. It also highlights the importance of developing a consultation strategy for regulatory proposals, including the requirement for each department and agency to publish, and update, an Annual Regulatory Plan.

The Government has tasked the OBPR with promoting the whole-of-government consultation principles and providing clear guidance on best practice consultation with stakeholders to be undertaken as part of the policy development process. If you need guidance in relation to a specific policy proposal, contact the OBPR.

## 4.2 Application of consultation principles

### Continuity

Meaningful consultation with key stakeholders should be a continuous process that starts as early as possible in the policy development process. Consultation should continue through all stages of the regulatory cycle, including when detailed design

features are being bedded down. This will assist in identifying and understanding potential problems, and in designing and implementing better regulation.

Regulators need to be involved in consultation to ensure that regulations can be administered in a manner that is consistent with the policy intent of government. Regulators need to maintain constructive relationships with key stakeholders to obtain information on the potential impacts of how regulation may be administered.

## Targeting

Departments and agencies must consider the scope of the proposed regulatory changes and consult widely to ensure consultation captures the diversity of stakeholders affected by the proposed changes.

Relevant individuals and groups may include:

- businesses, consumers, unions, environmental groups and other interest groups that will be affected;
- state, territory and local governments; and
- Australian Government departments, agencies, statutory authorities or boards.

It may be appropriate to distinguish between stakeholders within these main groups where the impacts of options are likely to differ. For example, businesses' views may vary depending on their size, nature of operations or location.

For consultation with business stakeholders, industry associations and small business groups may be a good starting point. However, these may not represent all stakeholders in a particular sector. Furthermore, large industry associations with a diverse membership may not have a consistent view on all aspects of a regulatory proposal. Consideration should be given to how best to engage individual stakeholders in the consultation process.

For community stakeholders, such as consumers, environmental groups and other interest groups, peak bodies may also be a starting point. However, these bodies may not represent all relevant stakeholders, and individual stakeholders should be included in the consultation process, where appropriate.

Relevant state, territory and local governments, and Australian Government departments and agencies, should be consulted to ensure that regulatory policies across jurisdictions are consistent and complementary. Efficient regulation requires that duplication of legislative requirements across agencies and government at all levels is avoided or minimised. This is particularly important where the regulatory

processes arise from negotiations between different levels of government and/or involve overlapping responsibilities.

## Appropriate timeliness

It is important that consultations are conducted early in the process when the policy objectives and different approaches to an issue are still under consideration. The Annual Regulatory Plan initiative (discussed in section 4.5) and the business consultation website (box 4.1) are two ways departments and agencies can alert stakeholders to potential regulation.

### Box 4.1 Business consultation website

The Australian Government is committed to improving consultation with business. The business consultation website is a mechanism to inform businesses about future regulatory activity and for the Government to work with stakeholders to obtain information, minimise compliance costs and improve regulation.

The business consultation website has been established by the Department of Industry, Tourism and Resources to:

- enable registration of relevant stakeholders prepared to be consulted on particular regulations;
- automatically notify stakeholders, including businesses and Government agencies, of consultation processes in areas where they have registered an interest;
- provide information on the Government's public consultation objectives and policies;
- include information about new and upcoming changes to regulation; and
- provide links to current and past consultation processes.

For more information, visit the business consultation website at www.consultation.business.gov.au

Timeframes for consultation should be realistic to allow stakeholders sufficient time to provide a considered response. Holiday periods and the end of the financial year should be avoided, particularly where stakeholders are small businesses. The amount of time required will depend on the specifics of the proposal (for example, the diversity of interested parties or the complexity of the issue). However, where prompt consideration of a proposal is required, some limitations on periods and timing of consultation may be unavoidable.

## Accessibility

The consultation process should be made accessible by using methods appropriate for the stakeholder groups that need to be contacted.

Agencies should inform stakeholders of proposed consultation via the most appropriate means, for example, press releases and advertisements in media, including newsletters of industry or community associations, and the business consultation website. The business consultation website will automatically notify businesses and government agencies of consultation processes in areas where they have registered an interest. The business consultation website and the Annual Regulatory Plan initiative are therefore cost-effective ways of alerting stakeholders to potential regulation.

Information provided to stakeholders should be easy to understand — it should be in an easily understandable format, use plain language and clarify the key issues, particularly where the proposed regulation addresses complex issues. Written consultation documents should include summaries to allow those consulted to quickly assess whether the material is relevant to them and whether they need to read further. Where appropriate, the publication of relevant information or issues papers on the website of the department or agency sponsoring the proposal will assist with accessibility.

Consultation can take a variety of forms other than written consultation, for example, stakeholder or public meetings, working groups, focus groups, surveys or web forums. The appropriateness of each approach will depend on the issues under consideration, the nature of the groups being consulted and the time available.

## Transparency

Involvement of stakeholders from the earliest possible stage in the policy development process will promote transparent and comprehensive participation.

The objectives of the consultation process should be clear. To avoid creating unrealistic expectations, any aspects of the policy proposal that have already been finalised and will not be subject to change should be clearly stated. For example, if a decision to regulate has been made already, stakeholders should be made aware that their views are sought primarily on regulatory design and implementation, not on the merits of the policy itself.

Being clear about the areas of policy on which views are sought will also increase the usefulness of responses. For example, explicitly stating any assumptions made

about those likely to be affected by the proposed policy or identifying particular areas where input would be valuable will encourage respondents to address these issues.

Stakeholders should also be made aware that policy development is guided by a regulation policy framework (including this Handbook and other materials) and that consultations with stakeholders will take place within this framework. Departments and agencies should respect the confidential nature of information provided by a party.

Information or issues papers — such as draft assessments of business compliance costs or draft RISs, green papers (policy options papers) or draft legislation — should, wherever possible and appropriate, be made available to stakeholders to enable them to make informed comments on policy proposals and proposed legislation. (Green papers and exposure drafts are discussed below.)

To provide credibility to the consultation process, policy agencies should also show stakeholders how they have taken consultation responses into consideration.

## Consistency and flexibility

Consistent consultation procedures can make it easier for stakeholders to participate in and understand the procedures. Consistent processes also permit better coordination of regulatory quality initiatives across a wide range of policy areas (avoiding the effect of regulatory 'capture' of departments/agencies by specific interest groups). However, consistency must be balanced with the need for consultation to be designed to suit the circumstances of the particular proposal under consideration.

In instances where ministers have made a commitment to a particular policy, consultation can improve the design of the proposal and help ensure that it minimises the compliance burden on business and costs to the community.

Public consultation for some proposals may be inappropriate (for example, where there is a need for Cabinet confidentiality, such as for national security or commercial-in-confidence matters). In some of these instances, an alternative may be for departments or agencies to consult with stakeholders in confidence. However, in other instances, it may not be possible to consult even on a restricted basis (for example, for new initiatives to deal with tax avoidance) although it may still be possible to undertake restricted 'early options' consultation with specialists outside government.

Consultation may not be appropriate for minor or technical amendments to regulation, for example, amendments that remedy errors or defects in existing regulation.

The OBPR can provide advice about the level of consultation appropriate to particular circumstances. It is important to consult the OBPR early in the policy development process so that sufficient time is available for the appropriate consultation process to be put in place.

### Evaluation and review

Policy agencies should evaluate consultation processes and continue to examine ways of making them more effective. For example, better use of information technology can improve the cost-effectiveness and timeliness of consultation processes.

Evaluation of the effectiveness of consultation processes may include examining the number and types of responses; whether some methods of consultation were more successful than others; and how consultation responses clarified the policy options and affected the final decision. Departments are encouraged to publish consultation protocols.

## 4.3 Green papers

For regulatory proposals of major significance, a policy options paper is required to be released as a basis for consultation. Commonly known as a 'green paper', it should contain most of the elements of a Regulation Impact Statement (RIS), such as the problem, objectives, some options (including a preferred option), identify the main groups affected by the options, and include a preliminary impact analysis. While a preferred option should be identified where possible, it is important that stakeholders are not left with the view that other options have been ruled out, otherwise they may limit their participation and reduce the effectiveness of the consultation process. The OBPR will advise if a green paper is required and should be consulted during its preparation.

The green paper, like other consultation documents, can be used to ask questions to fill information gaps and elicit specific feedback from stakeholders. It should be made clear where stakeholder input would be especially valued. Responses are likely to be more useful and focused if stakeholders know where to concentrate their effort. An issues paper or information paper may be an appropriate form of consultation for less significant proposals (see 'Transparency' in section 4.2).

## 4.4 Exposure drafts

Consulting on and analysing the implementation options is an important part of the policy development process. Prior to finalisation, the details of complex regulations are required to be tested with relevant business interests. This allows the 'devil in the detail' to be made transparent. Releasing exposure drafts of complex regulations for significant matters is one approach departments and agencies can use to allow businesses and other stakeholders to provide more detailed comments and advice on how a regulation will work in practice.

Where an exposure draft is required, in most cases a decision (informed by a RIS) choosing a regulatory option has already been made. Consequently, a two-staged decision-making process might occur. The existing RIS could be amended for the implementation decision to include the regulatory impact analysis and consultation processes associated with the exposure draft of the regulations. It is the amended RIS (covering both decision stages) that would be made public to make the entire policy development process transparent.

## 4.5 Consultation strategy

Early planning is essential to successful consultation.

Consultation is a continuous process that needs to start early in the policy development process. In some cases, there may be uncertainties associated with the policy, in which case consultation plans may evolve and be amended as the policy development process unfolds. Consequently, consultation plans provide a degree of consistency in consultation procedures, while at the same time allowing for some flexibility.

A consultation plan should ideally cover the whole policy-making process and identify the objective of consultations, relevant target groups, appropriate forms of consultation and consultation times. However, a balance will need to be struck between the scope and length of consultation and the obligation for the Government to work efficiently. In line with the Government's requirements for regulatory impact analysis, consultation should remain proportionate to the potential impacts of the proposal. While the quantity of consultation is important, the emphasis should be on achieving high-quality consultation.

Publishing a consultation plan provides information to stakeholders about future consultation opportunities. This improves the transparency of the policy development process and gives stakeholders early warning so they can contribute more effectively to the development of the policy.

## Annual Regulatory Plans

Consultation plans are a key part of the Annual Regulatory Plans that the Government requires each department and agency to develop and continuously update. The main objective is to provide stakeholders with an early indication of potential regulatory changes. Proposals requiring further regulatory analysis (Business Cost Calculator (BCC) report or RIS) and reviews of regulation should be included in Annual Regulatory Plans. These plans contain information about proposed regulatory activity, including a description of the issue, information about consultation opportunities and an expected timetable. (Guidelines for departments and agencies on preparing and publishing regulatory plans are available at www.obpr.gov.au) Contact the OBPR if you require assistance in preparing or updating your agency's plan.

Annual Regulatory Plans are published on the website of each department and agency and the OBPR provides links to the plans from its website. The plans are also linked to the business consultation website (www.consultation.business.gov.au), which aims to make consultation more effective.

To provide transparency and embed best practice consultation practices, the plans should cover the following.

- **What consultation has already occurred on the proposal?**

  Before preparing the preliminary assessment, it is appropriate for some form of consultation to have already been undertaken to gather information about the problem, objectives and options (both non-regulatory and regulatory). Consultation is required before a preferred option is 'locked in'.

- **What is the objective of each consultation round?**

  Depending on the significance of the proposal and the consultation objectives, multiple rounds of consultation may be appropriate. In developing a consultation plan, the objectives (what is the desired outcome) of each round of consultation should be clearly identified. For example, is the aim to gather new ideas (brainstorming), collect evidence and factual data, validate assumptions or clarify the possible impacts of a proposal on the wider community? Depending on the objectives, consultation can be undertaken on different elements of the impact assessment, such as the nature of the perceived problem, the Government's objectives, the options to address the perceived problem, a comparison of the impacts of the policy options, or on the entire proposal.

Identifying the objectives of consultation will help determine who should be consulted, how and when.

- **Who will be consulted at each round?**

  As discussed earlier (under 'Targeting' in section 4.2), departments and agencies should consult widely to ensure consultation encompasses the diversity of stakeholders affected by the proposal. The business consultation website is one tool to broadly advertise the proposal and seek participation by interested stakeholders. It aims to further improve consultation and to provide business with better access to Government information about regulation.

  It is also important to proactively identify relevant interested parties and those the proposal will be likely to affect. Consultation is also an opportunity to seek input and involvement from those who can make a meaningful contribution to the decision-making process. Business and community organisations and consultative bodies may be useful partners in identifying target groups and those with technical knowledge or subject matter expertise.

- **In what form will consultation occur at each round?**

  As mentioned under 'Accessibility' in section 4.2, consultation can take a variety of forms. The choice of the form of consultation will largely depend on the issues under consideration, who needs to be consulted, and the available time and resources.

  While written consultation is a common form of consultation, informal consultation with stakeholders potentially affected by the proposal should be conducted before any written consultation period. This should result in a more informed consultation exercise and ensure that stakeholders are engaged early and have a better understanding of the proposal.

  Information or issues papers may help to engage stakeholders early in the consultation process, while a draft RIS or draft assessment of business compliance costs may focus stakeholder attention on the objective of later consultation rounds.

  As mentioned earlier, for regulatory proposals of major significance, a green paper is required to be released as a basis for consultation, while for complex regulations an exposure draft of the regulations is required.

- **When will each round of consultation commence?**

  The appropriate timing of consultations must be determined on a case-by-case basis but, as mentioned earlier, consultation should start as early as possible in

order to maximise its impact on policy development. Consultation should also be seen as a recurring need in the policy development process, rather than as a one-off event.

The timing of consultations is inextricably linked to the objectives of consultation. An initial consultation might be held to ascertain stakeholder perceptions about the nature of the problem and the Government's objectives. A subsequent consultation might ask stakeholders for their views about the possible range of options and aim to sound out stakeholder acceptability of any preferred option. However, for efficiency reasons, the consultation process should be balanced in order to avoid 'consultation fatigue'.

Where a green paper is required, it should be released relatively early in the policy development process before a preferred option is 'locked in'. An exposure draft of the regulation should be released closer to finalisation, but still allow time for stakeholders to provide feedback about the 'details' and for their views to be addressed.

- **How long will the round last?**

A common complaint from business is the lack of time to provide feedback when asked for it[1]. Involving stakeholders, such as standing consultative bodies, in determining timelines can be an important part of building and securing a positive relationship. While longer periods of consultation might seem more appealing for stakeholders, the Government's aim is effective consultation and 'real listening'. Departments and agencies should provide realistic timeframes for participants to contribute. Where small businesses are potentially affected, they should be given sufficient time to consider the issue and respond, including allowing time for representative bodies to contact their members.

The length of consultation rounds depends on the nature and impact of the proposal, the objective of each round, the number of rounds, the form of consultation and who is being consulted. For example, where stakeholders are being asked to consider the whole proposal and there has been little previous consultation, a longer round is appropriate.

There is a broad range in the length of consultation rounds across departments and agencies. However, as a guide, six weeks seems appropriate for effective consultation where the quantification of business compliance costs is required. However, more time should be allowed for stakeholders to respond to highly

1 Regulation Taskforce 2006, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January, p. 150

significant proposals, with around 12 weeks an appropriate period. (In the United Kingdom it is a government requirement to allow a minimum of 12 weeks for written consultation at least once during the policy development process.)

Meaningful consultation with stakeholders throughout the policy development process should be documented in the RIS as a consultation statement. The adequacy criteria for the consultation statement are provided in part 5. The consultation statement should demonstrate to the decision maker that sound consultation practices were followed and, when the RIS is made public, show the Government's commitment to its best practice consultation principles.

# 5 Regulation Impact Statement outline and adequacy criteria

A brief picture of the elements that should be addressed in a Regulation Impact Statement (RIS) is presented in this part. In some cases, not all the items in this generic outline will be relevant, whereas in others a more detailed analysis of some items will be required. Policy officers should also note the following.

- Where a regulatory option *restricts competition*, departments and agencies must ensure that the RIS considers whether that option generates a net benefit *and* is the only way of achieving the policy objective.
- *Medium or significant compliance costs* must be quantified. Use of the Business Cost Calculator (BCC) has been endorsed by the Government to assist departments and agencies in this (although other methods may be used, as described in part 2).
- Where applicable, the analysis should assess impacts on *ecologically sustainable development*, including short-term and long-term changes to economic, social and environmental benefits and costs.
- Where a proposed regulation might have a direct bearing on *international trade* or export performance, agencies should consult with the Assistant Secretary, Trade and Economic Analysis Branch, Department of Foreign Affairs and Trade (telephone 02 6261 3220) to ensure that the RIS analysis meets the information requirements of a Trade Impact Assessment.
- New or amended *cost recovery* arrangements should be examined in a manner consistent with the Government's Cost Recovery Guidelines (DoFA 2005).[1]

The Australian Government's adequacy criteria for RISs are also provided below so that policy officers are aware of the 'goal posts' regarding the quality requirements. A detailed explanation and discussion of each RIS element is provided in part 6. Examples of RISs are available on the OBPR website (www.obpr.gov.au).

[1] DoFA (Department of Finance and Administration) 2005, *Australian Government Cost Recovery Guidelines*, July.

## 5.1 Generic outline of a Regulation Impact Statement

## 5.2 Adequacy criteria for Regulation Impact Statements

To be assessed as adequate, all seven elements of a RIS must contain a degree of detail and depth of analysis that is commensurate with the magnitude of the problem and the size of the potential impact of the proposals. Subject to this overriding principle, the following criteria (which follow the seven elements of a RIS), will be used by the OBPR to assess whether a RIS contains an adequate level of information and analysis.

### 1. Problem

The RIS should clearly identify the fundamental problems that need to be addressed. This part of the analysis must:

- present evidence on the magnitude (scale and scope) of the problem;
- document relevant existing regulation at all levels of government, and demonstrate that it is not adequately addressing the problem;
- if the problem involves risk, identify the relevant risks and explain why it may be appropriate for government to act to reduce them; and
- present a clear case for considering that additional government action may be warranted, taking into account existing regulation and any risk issues.

### 2. Objectives

The RIS should explain the objectives, outcomes, goals or targets of government action.

### 3. Options

The RIS should identify a range of viable options including, as appropriate, non-regulatory, self-regulatory and co-regulatory options. If only one option (apart from the status quo) is considered feasible, the RIS should provide sound justification for considering only two options.

### 4. Impact analysis

The RIS should provide an adequate analysis of the costs and benefits of the feasible options and:

- identify the groups in the community likely to be affected by each option and specify significant economic, social and environmental impacts on them;
- assess the costs and benefits of all the options, supported by an acceptable level of evidence, where appropriate through a formal cost-benefit analysis;
- assess the impacts on business, particularly small business, and quantify (using the BCC or equivalent approved by the OBPR) the effect of each option on business compliance costs;

- quantify other significant costs and benefits to an appropriate extent, taking into account the significance of the proposal and its impact on stakeholders;
- if an objective of regulation is to reduce risk, analyse the extent to which each option would reduce the relevant risk, and the costs and benefits involved;
- recognise the effect of the options on individuals and the cumulative burden on business;
- document any relevant international standards, and if the proposed regulation differs from them, identify the implications and justify the variations;
- if the proposed regulation would maintain or establish restrictions on competition, demonstrate that the Government's objective can be achieved only by restricting competition; and
- provide evidence to support key assumptions and clearly identify any gaps in data.

## 5. Consultation

The RIS should:

- outline the consultation objective;
- describe how consultation was conducted (including the stages of the policy development process at which consultation was undertaken, the timeframes given, and the methods of consultation);
- articulate the views of those consulted, including substantial disagreements;
- outline how those views were taken into consideration; and
- if full consultation was not undertaken, provide a reasonable explanation.

The consultation process reported in the RIS should conform with the Government's best practice principles and policy on consultation.

## 6. Conclusion and recommended option

The RIS should provide a clear statement as to which is the preferred option and why.

The RIS should demonstrate that:

- the benefits of the proposal to the community outweigh the costs; and
- the preferred option has the greatest net benefit for the community, taking into account all the impacts.

## 7. Implementation and review

The RIS should provide information on how the preferred option would be implemented, monitored and reviewed. Interactions between the preferred option and existing regulation of the sector should be clearly identified.

# 6 Preparing a Regulation Impact Statement

This part of the Handbook provides more detail on issues that should be considered when addressing each item contained in the generic outline (see part 5). Example Regulation Impact Statements (RISs) are available on the OBPR website (www.obpr.gov.au).

If you have any questions or require assistance, contact the OBPR.

While detailed guidance on RISs is provided in this part, policy officers should keep in mind that the level of analysis should be proportionate to the magnitude of the problem and the size of potential impacts of the proposal. As a rough guide, a RIS for a straightforward proposal might be six to eight pages and even for a highly complex proposal, the RIS could be less than 35 pages.

## 6.1 Assessing the problem

This first section of a RIS should specify the problem or issue that has prompted a consideration of government action. Information should be provided on the nature and magnitude of the problem and identify what government actions (if any) have been taken in the past to address the problem. Any underlying market failure (such as the presence of externalities), regulatory failure (for example, unintended consequences or ineffective existing regulation) or risk should also be identified. In this context, risk refers to a combination of the probability that a particular hazard will occur and cause harm (that is, that an undesirable event will occur) and the magnitude of the consequences of that adverse event occurring.

To provide guidance regarding the clear identification of problems and consequences of no action, the Government has endorsed a series of points that should be followed by officials considering proposals for new or amended regulation (see box 6.1).

Box 6.1 **Identifying the problem**

**Identify the problem**

Clearly define the problem, for example:

- market failure (such as a lack of or misleading information, presence of externalities or public goods, or use of excessive market power);
- regulatory failure (such as a government-imposed restriction on competition that is not in the public interest);
- unacceptable hazard or risk (such as human health and safety hazards, person or entity bearing risk ill equipped to do so, or threat of damage to the physical environment); or
- social goals/equity issues (such as individuals or groups being unable to access available market information, goods or services).

How significant is the problem? What is its magnitude? In the case of risk, what is the likelihood of the adverse event occurring? What evidence do you have to support this initial assessment?

How is the problem currently regulated by Australian Government, state, territory or local government regulations? Are there deficiencies in the existing regulatory system that, if corrected, might fix the problem?

Is there a case for government intervention or is the problem of purely private interest? Why does current regulation not properly address the identified problem?

**Assess the consequences of *no action***

List the consequences of no action.

Could relying on the market in conjunction with the general application of existing laws and regulations solve the problem? If not, why not?

Will the problem self-correct within a reasonable timeframe?

Can regulation improve the situation?

### 6.1.1 What is the problem being addressed? How significant is it?

To design appropriate and well-targeted solutions, the problem should be specified clearly and put in perspective. Otherwise, unnecessary or inappropriate regulation may result, or the problem may not be solved. Specification of the problem should include details of its nature and magnitude.

The problem should be specified in terms of the loss, harm or other adverse consequences that are being experienced, or are likely to be experienced, by groups

within the community if action is not taken. This section of the RIS should explain the nature of these undesirable impacts, and identify those affected.

The impact (high, medium or low) of the problem should also be estimated in a preliminary way[1], including by consulting affected parties. If this investigation indicates the problem has low impact, it is likely there will be no case for government action or regulation. This is because government action is not costless and can bring with it often unforeseen, adverse consequences. If the impact of the problem on the community is expected to be larger, preparation of the RIS will help indicate whether government action is potentially beneficial.

When identifying the nature and size of the problem, where possible, reference should be made to empirical evidence as well as perceptions of the problem. An evidence-based approach to identifying the problem is required, and the scale and scope of the problem should be quantified. This includes assessing the worst and best outcomes that could occur if a 'do nothing' approach were taken. If the problem involves risk to the public, businesses, workers or the environment, the extent of hazard and the likelihood that it will occur should be identified (see appendix C for an introduction to risk analysis).

### 6.1.2 Why is (new) government action needed to correct the problem?

The fact that a 'problem' is observed does not necessarily mean that government intervention is justified as not all issues can be effectively addressed by government regulation or other intervention. Furthermore, government action is not costless, and there is therefore an onus on the department or agency proposing action to describe why government involvement is required to deal with the identified problem. In deciding whether government intervention is appropriate, a number of questions need to be considered.

- Is the problem a direct or indirect consequence of existing Australian Government, state, territory or local government regulation?
- Is the problem one that market forces could ultimately address, or is there evidence of a market failure?
- If the problem involves risk to members of the community, is the risk great enough to warrant intervention, or is the level of risk acceptable if weighed against the costs of correcting for it?

[1] Note that this is a preliminary examination of the size of the problems, rather than a preliminary assessment of the impact of proposed regulation (which is covered in part 3).

- Is the problem one that the Government has the capacity to deal with effectively?

Government action has often been justified in cases of 'market failure'. Market failure refers to situations where markets do not produce economically efficient outcomes, for example:

- when there is a natural monopoly and potential for abuse of market power;
- if there is an inherent lack of adequate information available;
- when goods or services are 'public goods'; or
- when there are impacts on third parties (externalities or spillovers) that are not reflected in market prices and are unlikely to be corrected by market forces.

These types of market failure are discussed in box 6.2.

If the justification for government action is based on market failure, the precise nature of the market failure should be identified. For instance, the problem may be that irrigators do not take account in their decision making of the environmental costs, such as salinity, resulting from their use of water (an externality). Or the problem may be the inability of consumers to ascertain the quality of services provided by health care professionals before purchase (information asymmetry).

While the existence of market failure indicates that there may be a role for government action to make the community better off, policy officers still need to consider whether government is in a position to improve the situation. For instance, consumers may lack information regarding certain decisions that may have an adverse impact on them. However, unless the Government has additional information (beyond that held by the consumer), it is unlikely to be in a position to correct the market failure.

### 6.1.3 Is there relevant regulation already in place? Why is additional action needed?

Governments may previously have taken action to address the underlying problem. Where this is the case, the characteristics of existing regulation at all levels of government (Australian Government, state/territory and local) should be documented, and the responsible regulatory organisations and relevant government policy identified. There should be an analysis of how effective the existing regulation has been in addressing the problem. What is the evidence that the existing regulation does not deal with the problem adequately?

## Box 6.2 **Market failure**

When markets are functioning well, they tend to allocate resources to their most valued uses. Market failure refers to certain situations in which markets may fail to allocate resources efficiently. Market failure, by itself, does not indicate that government intervention is warranted, as the costs of this may outweigh the benefits. Moreover, there are legitimate rationales for government intervention that do not depend on market failure, for example, equity. Government intervention can only be justified if it leads to an overall improvement in community welfare.

**Monopoly and abuse of market power**

Problems of market power may arise from uncompetitive market structures or from anti-competitive conduct. Monopoly power is said to exist when one, or relatively few, producers are able to restrict output and maintain prices higher than at competitive levels. Generally, this requires a market with few producers, and goods with no or few close substitutes. Firms may also acquire market power by cooperating to maintain higher prices, although such cooperation would usually be in breach of general competition laws governing anti-competitive conduct.

Care should be taken not to assume that any market with few producers is characterised by market power. Generally, a barrier to entry (such as regulation or a patent over a product) is required to prevent other businesses from entering the market when an existing firm attempts to raise prices above their competitive level. Identifying this barrier to entry is a key element of regulating in the case of monopoly power.

**Asymmetric information**

Markets may not allocate resources efficiently if one party in a transaction has significantly more information about a good or service than another. Sellers and buyers may have an incentive to conceal information about a good or service in order to obtain a more favourable price or conditions in a transaction.

It should be noted that, over time, markets can develop responses to issues of imperfect information about goods and services. Buyers may share their experiences with other potential buyers. Sellers may provide guarantees or warranties. Third parties (or government) may offer certification services or insurance, or may collect and publish information about a range of goods and services.

**Externalities (external costs and benefits)**

An externality occurs when one party imposes on others benefits that are not paid fo,r or costs that are not compensated through market prices. For example, a factory may pollute a river to the detriment of other users of the river. Alternatively, individuals may choose to drive on already congested roads, increasing the congestion and imposing costs on other road users.

As most activities generate some form of externality (positive or negative), the existence of an externality does not on its own justify government intervention. The determining factors include the size and nature of the externality, and the likelihood that government intervention will be successful in addressing the externality at relatively low cost.

(Continued on next page)

Box 6.2 **(continued)**

**Non-rivalrous goods**

These are a special case where the good or service, once provided by an individual or government, can be consumed by more than one person simultaneously (without loss of benefits). Examples include national defence, fireworks displays and lighthouses. In essence, their provision by one party provides positive externalities for many others.

**Non-excludable goods**

These are goods where, once provided, others can not be excluded from consuming the good. For example, it is difficult to exclude individuals from receiving a (public) television broadcast or visiting a national park. Crucially, while virtually all goods or services are technically excludable, it is the cost of this exclusion that may make it prohibitive. For example, it may be possible to exclude individuals from a national park by posting sentries around the border, but this would be prohibitively expensive. It is important to note that developments in technology may reduce the costs associated with exclusion.

*Public goods*

Public goods are goods or services that are both non-excludable and non-rivalrous. That is, anyone can simultaneously have access once they are provided, and use by one person does not reduce availability to others.

As a consequence, so long as people believe that others also desire the good and that it is likely to be made available, then each individual is unlikely to contribute voluntarily to its provision. Therefore, free markets may provide fewer public goods and services than the community as a whole would be willing to pay for, and government intervention may be required to ensure such goods are provided.

*Common property resources*

Goods or services that are non-excludable but rivalrous are known as common property resources. Such goods are likely to be over used and can be subject to congestion. This can occur, for example, if there are no restrictions on the use of the resource, or no price is charged for it. In the absence of property rights, individual users will lack complete incentives to manage or conserve the resource for later use.

Examples of common property resources may be the stock of fish in an ocean, a public beach or a congested road.

*Toll goods*

Goods or services that are jointly consumed (non-rivalrous) but excludable are known as toll goods. Examples of such goods include subscription TV and computer software. While such goods can often be (efficiently) provided by the market, government intervention may be necessary in some cases (depending on the cost of the good or service, the value placed on it by consumers, and the toll the market will support).

If you would like more advice on whether an issue you are dealing with is potentially a market failure, contact the OBPR.

If it is clear that existing regulation is failing to deal with the problem in an acceptable way, is this because the regulation is flawed, or because there are problems with compliance? Could the situation be dealt with by improving enforcement or encouraging better compliance with the existing regulation?

## 6.2 Objectives of government action

### 6.2.1 What are the objectives, outcomes, goals or targets of government action?

This step in the RIS should identify what objectives, outcomes, goals or targets are sought in relation to the identified problem. A common error is to confuse the desired final outcome of a proposal with the means of obtaining it. For example, a broad objective of government health-related regulation may be 'to reduce the health care costs associated with smoking'. This objective differs from a narrower objective of 'banning smoking in certain venues', which is one of many means of attaining the broader objective.

The objective should be clear. It should not pre-justify a preferred solution, but should be specified broadly enough to allow consideration of all relevant alternative solutions. However, it should not be so broad or general that the range of alternatives becomes too large to assess, or the extent to which the objective has been met becomes too hard to establish.

If applicable, a distinction should be made between the primary and any subsidiary objectives of the proposal.

If outcomes are subject to constraints, for example, if they must be achieved within a certain time frame, these should also be specified clearly within the statement of objectives.

If there is an authoritative basis for the proposal to review regulations, for example, a relevant Cabinet minute or government policy announcement, this should be identified clearly.

## 6.3 Options that may achieve the objectives

This section of the RIS should set out the alternative regulatory and non-regulatory options that could wholly or partly achieve the objectives specified in section 6.2. It

should provide a description of each feasible option that explains how the option, if implemented, would achieve the desired result.

Alternative regulatory forms that can be considered include self-regulation, quasi-regulation, co-regulation and explicit government regulation. In addition, different types of regulation within these forms might be viable options for analysis.

### 6.3.1 Identify a range of viable options, including non-regulatory options

To help decision makers select the most effective and efficient approach, the RIS should test the effectiveness and appropriateness of alternative (regulatory and non-regulatory) options for achieving the stated objectives.

As it is impractical to assess in detail every possible alternative solution to a problem, it is necessary to cover the most feasible range of options. However, the reasons for rejecting options without detailed analysis should be stated. Section 6.4 discusses how to apply a cost-benefit analysis to options.

If any of the options involve establishing or amending standards in areas where international standards apply, the RIS should indicate whether the standards under consideration deviate from the relevant international standards. If this is the case, the RIS should provide an explanation for the variation and examine the implications of this variation (see section 6.4.3).

A ‘do nothing’ or status quo option should always be included in the analysis. It is the base case against which alternatives can be compared.

#### *Alternative regulatory forms*

Some introductory information on different regulatory forms that can be considered is provided below. Appendix A provides more detailed information.

To provide guidance on the most appropriate approach, the Government has also endorsed checklists for each regulatory form that should be used by all officials considering proposals for new or amended regulation. The checklists are intended to supplement the RIS process by providing additional information to help determine which regulatory forms are worth considering, prior to the more formal testing in the RIS of the effectiveness and likely costs and benefits of different regulatory options.

*Self-regulation*

Self-regulation is generally characterised by industry formulating rules and codes of conduct, with industry solely responsible for enforcement. In most cases, self-regulation should be one of the first options considered within the RIS framework (see box 6.3).

Box 6.3 **Checklist for the assessment of *self-regulation***

**Self-regulation should be considered where**:

- there is no strong public interest concern, in particular, no major public health and safety concern;
- the problem is a low-risk event, of low impact or significance; and
- the problem can be fixed by the market itself. For example, there may be an incentive for individuals and groups to develop and comply with self-regulatory arrangements (industry survival, market advantage).

**The likelihood of self-regulatory industry schemes being successful is increased if there is:**

- adequate achievable coverage of industry concerned;
- a viable industry association;
- a cohesive industry with like-minded or motivated participants committed to achieving the goals;
- evidence that voluntary participation can work — effective sanctions and incentives can be applied, with low scope for the benefits being shared by non-participants; and
- a cost advantage from tailor-made solutions and less formal mechanisms, such as access to quick complaints-handling and redress mechanisms, or the need to make regulatory adjustments quickly to meet developing market circumstances.

However, care must be taken to ensure any proposed self-regulatory approaches are not anti-competitive, for example, by restricting the entry of new market participants or discouraging the adoption of new technology.

*Quasi-regulation*

Quasi-regulation includes a wide range of rules or arrangements where governments influence businesses to comply, but which do not form part of explicit government regulation. Some examples of quasi-regulation include industry codes of practice developed with government involvement, guidance notes, industry–government agreements and accreditation schemes (see box 6.4).

Box 6.4 **Checklist for the assessment of *quasi-regulation***

**Quasi-regulation should be considered where:**

- there is a public interest in some government involvement in addressing a community concern and the issue is unlikely to be addressed by self-regulation;
- there is a need for an urgent, interim response to a problem in the short term, while a long-term regulatory solution is being developed;
- government is not convinced of the need to develop or mandate a code for the whole industry;
- there are cost advantages from flexible, tailor-made solutions and less formal mechanisms; and
- there are advantages in the government engaging in a collaborative approach with industry, with industry having substantial ownership of the scheme. For this to be successful, there needs to be:

– a specific industry solution rather than regulation of general application;
– a cohesive industry with like-minded participants, motivated to achieve the goals;
– a viable industry association with the resources necessary to develop and/or enforce the scheme;
– effective sanctions or incentives to achieve the required level of compliance, with low scope for benefits being shared by non-participants; and
– effective external pressure from industry itself (survival factors), or threat of consumer or government action.

As in the case of self-regulation, proposed approaches should not restrict competition.

### *Co-regulation*

Co-regulation typically refers to the situation where industry develops and administers its own arrangements, but government provides legislative backing to enable the arrangements to be enforced. This is known as 'underpinning' of codes, standards and so on. Sometimes legislation sets out mandatory government standards, but provides that compliance with an industry code can be deemed to comply with those standards. Legislation may also provide for government-imposed arrangements in the event that industry does not meet its own arrangements.

### *Explicit government regulation (black letter law)*

Explicit government regulation — sometimes referred to as black letter law — comprises primary and subordinate legislation. It is the most commonly used form of regulation (see box 6.5).

While it can have a number of advantages when compared with other forms of regulation, there are also several important disadvantages associated with its use. The main advantages relate to its certainty and effectiveness because of the availability of legal sanctions. The potential drawbacks include that it may be standardised and inflexible; take significant time to make or amend; not be suitable for influencing the quality of complex services; be perceived to be difficult to understand (affecting compliance); have higher government budgetary costs and compliance costs (where it does not reflect accepted commercial practices); and provide poor access for those without means to pursue their legal rights (because of justice system costs and delays). For more information about the strengths and weaknesses of explicit government regulation, refer to appendix A.

Box 6.5 **Checklist for the assessment of *black letter law***

**Explicit government regulation should be considered where:**

- the problem is high risk, of high impact or significance, for example, a major public health and safety issue;
- the community requires the certainty provided by legal sanctions;
- universal application is required (or at least where the coverage of an entire industry sector or more than one industry sector is judged as necessary);
- there is a systemic compliance problem with a history of intractable disputes and repeated or flagrant breaches of fair trading principles, and no possibility of effective sanctions being applied; and
- existing industry bodies lack adequate coverage of industry participants, are inadequately resourced or do not have a strong regulatory commitment.

### *Alternative instruments*

Within each form of regulation, a number of alternative instruments can often be used. Alternative instruments (only some of which will be relevant for a particular type of regulatory form) may include:

- no specific action (that is, rely on the market in conjunction with existing general liability laws (negligence or breach of contract) and insurance laws);
- information and education campaigns (including product labelling or media campaigns);
- market-based instruments (including taxes, subsidies, tradeable permits, performance bonds and tradeable property rights);
- pre-market assessment schemes (such as listing, certification and licensing);

- post-market exclusion measures (such as bans, recalls, licence revocation provisions and 'negative' licensing);
- service charters;
- standards (including voluntary and regulatory, performance-based or prescriptive); and
- other mechanisms, such as public information registers, mandatory audits and quality assurance schemes.

Where voluntary standards are developed by Standards Australia and other third parties and are used for regulatory purposes, the Government has decided that it must be demonstrated in a RIS that those standards are the most effective means of achieving the relevant policy objective.

## 6.4 Impact analysis — costs, benefits and risks

The Government requires that RISs include a comprehensive assessment of the expected impact (costs and benefits) of each feasible option. The objective should be to choose the most appropriate option for resolving the identified problem and to provide readily accessible evidence to support this decision. The overall expectation is that the benefits to the community of the recommended option exceed its costs and have the greatest net benefits (benefits minus costs) to the community of all alternative approaches considered.

The quality of the analysis is a key consideration in the assessment of whether the RIS is of an adequate standard. The level of detail and depth of the analysis should be commensurate with the magnitude of the problem and the size of the potential impacts of the proposal. The OBPR can provide advice on the appropriate level of analysis for a given proposal.

Qualitative, quantitative and risk analysis, along with technical and scientific evidence, all have a role to play in the impact analysis of a particular option.

The analysis of each option should consider who would be affected if the option were implemented, what costs, benefits and, where relevant, levels of risk would result, and how significant they would be. Where possible, impacts should be quantified. At a minimum, the analysis should attempt to quantify all highly significant costs and benefits and all medium and significant business compliance costs. All assessments of costs and benefits, whether quantitative or qualitative, should be based on evidence, with data sources and assumptions clearly identified.

The status quo should generally be used as the benchmark for assessing the costs and benefits of each option. This will facilitate comparison of the options, leading to a conclusion about which option is likely to achieve the best result. It will also provide clear information about the extent of the net benefit that would result from implementing the preferred option.

To assess the costs, benefits and, where appropriate, level of risk associated with each option, it is essential to present a clear picture of how each option would change the status quo. Accordingly, the analysis should clearly explain how the actions, obligations and circumstances of different stakeholder groups are likely to change if the option is implemented.

If options have been described in relatively general terms in the *Options* section of the RIS, it may be necessary to provide a more detailed description of what each option will entail in the *Impact analysis* section.

In addressing the following items of an impact analysis, consultation with other departments, business and the community is likely to provide useful information on the effects of each option.

Key issues to be addressed in this part of the RIS are discussed in more detail below.

### 6.4.1 Who is affected by the problem and who is likely to be affected by proposed solutions?

An impact analysis should be evidence-based and comprehensive. This means that all groups affected by the problem and its proposed solution must be identified, including those directly affected by the options and those indirectly affected. In addition, the effects on the community as a whole should be assessed.

In the past, some departments and agencies have perceived RISs as 'business impact statements'. While an impact on business is a trigger for preparing a RIS, the impact of an option on all affected groups in the community needs to be considered and compared when an impact analysis is prepared.

Groups may initially be distinguished as consumers, business and government. These groups may then need to be further subdivided, for instance:

- within the consumer group it may be necessary to distinguish groups according to income, geographical location (regional and rural), age, family unit, cultural background or levels of information held;

- within business, distinctions may be made along industry or sectoral lines, or by type of activity; and
- within government, whether impacts are at the Australian Government, state/territory and/or local government level.

The extent to which groups need to be separately identified in a RIS will vary according to the problem and option being assessed.

### 6.4.2 Identify and categorise the expected economic, social and environmental impacts of the proposed options as likely costs and benefits

Costs and benefits are terms used to describe the positive and negative effects of a proposal.

A cost is any item that makes someone worse off, or reduces a person's sense of well-being. Cost items should include 'opportunities forgone' because a particular proposal has been adopted. A benefit includes any item that makes any person better off, regardless of whether it can be easily measured or quantified.

*Costs*

Costs to businesses, including small business, might include:

- 'paper burden' or administrative costs to businesses associated with complying with and/or reporting on particular regulatory requirements;
- licence fees or other charges levied by government;
- changes likely to be required in production, transportation and marketing procedures;
- shifts to alternative sources of supply;
- higher input prices; and
- restricted access to markets.

It is important to note that where there are medium or significant business compliance costs, these costs should be quantified using the Business Cost Calculator (BCC) or an approved equivalent (see section 6.4.5).

Costs to consumers may include:

- higher prices for goods and services resulting from restrictions on competition;

- reduced utility (quality, choice etc) of goods and services; and
- delays in the introduction of goods to the marketplace and/or restrictions in product availability.

Costs to the community and/or the environment may include:

- environmental degradation or pollution;
- reduction in health and safety;
- undesirable redistribution of income and wealth; and
- lower employment levels or economic growth.

Costs to government may include:

- running education campaigns/providing information;
- administration of licensing/inspection services;
- collection and collation of business information; and
- enforcement costs.

### *Benefits*

The benefits of the options to business, consumers, government, other affected groups and the community at large should be identified and described. Many benefits may not be readily quantifiable (see section 6.4.4 for discussion of the extent to which quantification is required). Examples of benefits include:

- improvements in product and service quality;
- availability of a wider range of products and services;
- reductions in costs or prices;
- reductions in workplace accidents and improvements in public health and safety;
- improvements in environmental amenity;
- reductions in compliance costs for business and administrative costs for government; and
- improvements in the information available to business, the workforce, consumers or the government.

### 6.4.3 Assess the costs and benefits that will be experienced by different stakeholder groups, including small business, and by the community as a whole

This section should provide a detailed assessment of the extent of costs and benefits of each option on different groups in the community, forming the basis for a comparative analysis that will eventually lead to a conclusion about which option is preferred.

The impact analysis should be comprehensive and include all economic, social and environmental costs and benefits, not just those of a financial nature. For example, where applicable, the analysis should include costs and benefits relating to matters such as changes in environmental amenity and health and safety outcomes, resource allocation and reductions in risk. The extent to which quantification of costs and benefits is required in the RIS analysis depends on the significance of the impacts of the options under consideration. This is discussed in more detail below.

The distributional effects of each option are also important in determining the overall outcomes for the community. For example, while a particular option may generate net benefits in aggregate, significant benefits may go to a small number of people who bear no costs, while the costs may be borne by a large number or by those who can least afford it. While, theoretically, government could compensate the losers from the gains of the winners, this may be difficult to achieve in practice and would entail administrative costs.

In quantifying the net impacts of each option, it is important to avoid double counting. For example, if a cost to businesses is passed on to consumers, the cost should be counted only once when estimating the net impact.

To ensure that all the impacts of each option are identified, it is useful to consider how the proposal is expected to impact on each group identified in section 6.4.1. Where there are medium or significant compliance costs on business, these should be quantified using the BCC or an approved equivalent (see section 6.4.5).

There are some additional government requirements, set out below, that must also be addressed if the RIS deals with options that:

- will restrict competition;
- will affect small business, export performance or ecologically sustainable development;
- involve cost recovery by the government; or
- adopt standards that deviate from relevant international standards.

### *Restrictions on competition*

Many existing and proposed regulations and requirements restrict competition. Such regulations can restrict consumer choice, raise prices and reduce overall economic productivity by denying the economy the dynamic efficiency gains competition provides. Significant restrictions on competition, targeted by National Competition Policy, range from legislated monopolies that block competition in entire sectors to a host of less visible restrictions on starting up and operating businesses, such as quotas on business licences and restrictions on shop opening hours. For instance, licensing requirements to promote health and safety objectives may also limit the number of people engaged in an industry or occupation, allowing existing practitioners to raise their charges. Similarly, permitting only some producers to use certain terms on their labels can restrict competition, limiting supply and raising prices to consumers.

Where a particular option restricts competition, the RIS must address additional issues in the context of the cost-benefit analysis in order to meet the Commonwealth's commitments under the intergovernmental Competition Principles Agreement. In particular, the RIS must examine whether the recommended/preferred option is the only way of achieving the desired objective. This is because the RIS should not recommend an option that restricts competition unless it is demonstrated that the benefits of the restriction to the community as a whole outweigh the costs, and the desired objective can be achieved only by restricting competition.

Where the competition checklist set out in box 3.5 indicates that the proposal may restrict competition, the RIS will need to include a competition assessment (see box 6.6). You should contact the OBPR for advice on the use of the checklist and whether a competition assessment is required for a specific proposal.

### *Effects on small business*

The Government has asked all departments and agencies to ensure that particular effects on small businesses of proposed new and amended legislation and any other regulation are made explicit in the RIS. The RIS should also give full consideration to the Government's objective of minimising the paperwork and regulatory burden on small business.

The RIS should include a sub-section that assesses the impact of each option on small business compliance costs and paperwork burden (see box 6.7).

## Box 6.6 **Competition assessment**

If the answer to any of the questions in the **Competition Assessment Checklist** in box 3.5 is 'yes', then a **competition assessment** should be done.

The extent of this assessment should be commensurate with an initial assessment of the extent of the anti-competitive impact identified. It should involve an evaluation of the impact (for primary and relevant related markets) of the regulatory proposal on the following.

- *Incumbent businesses.* Will the proposed regulation affect incumbent firms differently, altering competitive relations between them in a way that would reduce the intensity of competition in the market as a whole?
- *Entry of new businesses*. Will the proposed regulation restrict entry for all (or particular types of) new businesses? What is the likely degree of this restriction and is it likely to significantly reduce competitive pressures in the longer term?
- *Prices and production*. Will the regulation raise prices by imposing new costs on producers? Will it facilitate information exchange among producers, raising the prospect of collusion and increasing prices? Is it likely to lead to the exit of some incumbent firms, reducing supply and increasing prices?
- *Quality and variety of goods and services*. Does the regulation include minimum standards requirements that will reduce the range of price/quality combinations available in the market? Is it likely to reduce product variety by restricting the entry of new firms?
- *Innovation.* Does the regulation restrict innovation (and therefore responsiveness to consumer needs)? Regulation may diminish pressures on incumbents to innovate by restricting entry by new firms or advertising of new products. Regulation may reduce entry of innovative products originating in other markets by restricting the movement of goods and/or services over borders.
- *Market growth*. Is the regulation likely to limit market growth, either by increasing costs to all producers or by limiting the possibility of entry by new firms?
- *Related markets*. Does the regulation in one market also have anti-competitive effects in upstream markets (those that supply inputs to the market in question), or in downstream markets (those in respect of which the product of the market in question constitutes an input, or intermediate good)?

The results of this assessment should be compared with assessments of feasible alternative policy options that would equally obtain the policy goal but be less anti-competitive. If there are no available alternatives, the proposal should be assessed from the perspective of economic well-being (that is, whether there are net benefits from the regulation, taking into account the costs of the anti-competitive impacts).

## Box 6.7 **Effects on small business**

Regulation can have a disproportionate impact on small businesses. Often, small firms have to divert a greater proportion of their resources to meeting regulatory requirements. In addition, small businesses are less likely to have specialist staff (such as lawyers, accountants or human resource professionals) with detailed knowledge of regulation. While such impacts may be unavoidable (or even desirable), it is important that decision makers are aware of all impacts imposed on small business.

*What is a small business?*

The Australian Bureau of Statistics (ABS) defines a small business to be any business with less than 20 employees. This is the definition that is usually applied in the regulatory assessment process, though others may be used provided an explanation is provided in the RIS.

*What should be included in the RIS?*

The RIS should provide a complete and accurate picture of the impacts on these businesses (while taking into account the significance of this information to the decision). The RIS should consider:

- the degree of impact on individual small businesses;
- the number of small businesses affected;
- the overall impact on small business; and
- whether this impact is in proportion to the impacts on other businesses or groups.

Particular attention should be paid to the compliance cost impact on small business. In addition to considering the particular ability (or inability) of these businesses to absorb such costs, the RIS should consider how widely the burden will fall.

*Consultation with small business is important*

Consultation with stakeholders will assist in determining the nature, magnitude and likelihood of any impacts on small business. Where small business is not represented in the main stakeholder group (as may happen where a proposal indirectly affects small business), additional consultation may be required. In cases where the effect is potentially significant, individual businesses or industry representative bodies may need to be approached. Information to assist in assessing the overall effect, such as the number of small businesses in a given industry or geographic location, the number of small business employees or the amount of small business turnover, may be available from the ABS or industry associations.

### *Effects on trade*

Where a proposed regulation has a direct bearing on export performance, a Trade Impact Assessment should be incorporated into the RIS. The Trade Impact Assessment should summarise the impact of regulatory options and proposals on exporters, and assess the overall impact on Australia's international trade. Departments and agencies should contact the Assistant Secretary, Trade and Economic Analysis Branch, Department of Foreign Affairs and Trade (telephone 02 6261 3220) with queries regarding when a Trade Impact Assessment is required and for advice on the form it should take.

### *Ecologically sustainable development*

Where applicable, the analysis should also assess any impacts on ecologically sustainable development, including short-term and long-term economic, social and environmental costs and benefits. Specifically, the analysis should consider whether the proposal is consistent with the application of the seven ecologically sustainable development principles and the extent to which it meets the three core objectives, as set out in box 6.8.

Supplementary material is available from the OBPR website (www.obpr.gov.au).

### *Cost recovery*

Where a regulatory proposal is to be funded through cost recovery charges, a Cost Recovery Impact Statement may need to be prepared and included within a RIS, in accordance with the Department of Finance and Administration's *Guidelines on Preparing Cost Recovery Impact Statements*. If required, a Cost Recovery Impact Statement should be separable from the RIS (more details are provided in appendix E).

### *Deviation from international standards*

If one or more of the options being considered would involve establishing domestic standards that deviate from directly relevant international standards, the RIS must specifically address the implications of this variation. The RIS should document the relevant international standards, discuss any reasons why it may not be appropriate to adopt those standards unchanged, and examine the implications of having a domestic standard that differs from international standards.

## Box 6.8 Objectives and principles of ecologically sustainable development

The National Strategy for Ecologically Sustainable Development was endorsed by all Australian Governments in 1992. It states that ecologically sustainable development:

'… aims to meet the needs of Australians today, while conserving our ecosystems for the benefit of future generations'.

### Core objectives

The strategy articulates three core objectives:

- enhance individual and community well-being and welfare by following a path of economic development that safeguards the welfare of future generations;
- provide for equity within, and between, generations; and
- protect biological diversity and maintain essential processes and life support systems.

### Guiding principles

The strategy's seven guiding principles are:

- decision-making processes should effectively integrate both long-term and short-term economic, environmental, social and equity considerations;
- where there are threats of serious or irreversible environmental damage, lack of full scientific certainty should not be used as a reason for postponing measures to prevent environmental degradation (known as the precautionary principle);
- the global dimension of environmental impacts of actions and policies should be recognised and considered;
- the need to develop a strong, growing and diversified economy which can enhance the capacity for environmental protection should be recognised;
- the need to maintain and enhance international competitiveness in an environmentally sound manner should be recognised;
- cost-effective and flexible policy instruments should be adopted, such as improved valuation, pricing and incentive mechanisms; and
- decisions and actions should provide for broad community involvement on issues which affect them.

These guiding principles and core objectives need to be considered as a package. No objective or principle should predominate over the others. A balanced approach is required that takes into account all these objectives and principles to pursue the goal of ecologically sustainable development.

*Source:* Commonwealth of Australia 1992, *The National Strategy for Ecologically Sustainable Development*, AGPS, Canberra.

If the preferred option is to adopt a standard that deviates from relevant international standards, the RIS must demonstrate that the benefits of this approach outweigh the costs to stakeholders of having divergent domestic and international standards, and that such deviations are permitted under international agreements to which Australia is a party.

### 6.4.4 Quantify these impacts where significant

Where the overall impacts of an option or the impacts on particular stakeholder groups are significant, they should be quantified. As noted below, some impacts of regulation are particularly difficult to quantify. For instance, the impact may be highly uncertain, intangible in nature and/or spread across diverse groups of people. However, quantification is important for a number of reasons and policy officers are expected to quantify all significant impacts where feasible.

Quantification helps in achieving several aims, including:

- providing comprehensive and comparable information to decision makers;
- encouraging close examination of the nature and impact of costs and benefits;
- encouraging reduction in the costs associated with regulation; and
- clarifying the essential assumptions and judgements that underpin the decision about which is the preferred option.

It should be noted that in many areas there may be uncertainty surrounding quantified estimates and there may be a number of assumptions made in order to generate quantified estimates. While these may reduce confidence in the estimates, it is important that they are still included in the RIS (to give decision makers as much relevant information as possible). Appropriate qualification and explanation should also be included, as well as an explanation of why better estimates are not achievable.

To allow a comparison between alternative options, costs and benefits need to be valued in a consistent manner. In many cases, impacts can be quantified in monetary terms. Examples include compliance costs and changes in the prices of goods and services.

Changes in social or environmental outcomes may be quantifiable, as a reduction in lives lost, or a change in the probability of an event occurring, but are not as readily quantifiable in monetary terms. This can make it difficult to aggregate the impacts of each option and identify the option with the highest overall net benefit to the community. However, there are techniques that can be used to place a value on costs and benefits, even when there is no market data available.

The OBPR should be consulted for advice on the extent to which the costs and benefits of a particular option need to be quantified. In general, the depth of the impact analysis should be commensurate with the impacts. For example, a comprehensive and detailed qualitative analysis, supported by quantitative evidence where it is available or readily obtained, would suffice if the option is expected to have relatively minor impacts overall, and will not have a major impact on any stakeholder group. In this case, the time and expense involved in additional quantitative analysis would not necessarily be justified.

However, for major proposals, RISs will need to quantify and value most or all impacts, unless there are strongly argued reasons for not doing so. For these proposals, a full cost-benefit analysis will often be appropriate.

Full (or formal) quantitative cost-benefit analysis is a technique used to assess the net benefit of options and its use in RISs has been endorsed by the Australian Government. Quantitative cost-benefit analysis is a comprehensive form of analysis that involves calculating the total benefit associated with an option and comparing this to its total cost over the life of the option. Usually costs and benefits are measured in dollar terms, allowing disparate costs and benefits to be added together to arrive at a net figure of the option's overall impact on the community. If a net benefit results after taking into account all the impacts, the option is judged as potentially attractive (although to the extent that equity impacts are important for a given regulation, these would need to be considered alongside the cost-benefit analysis). See appendix B for more information on quantitative cost-benefit analysis.

### *Valuing costs and benefits where there is no market*

Some of the costs and benefits of different options can be readily quantified in monetary terms because market data are available (for example, the cost of modifying a product to comply with a new energy efficiency standard). However, it is more difficult to value impacts where there is no 'market' for them. Such impacts may include a reduction in the incidence of disease, the avoidance of pollution, the protection of an endangered species, improvements in social outcomes and reductions in deaths or serious injuries.

Several techniques can be used to value impacts. Benefits may be valued using 'willingness to pay', which is determined by inferring a price from observed consumer behaviour or by asking people what they would be willing to pay (within a given budget constraint) for the particular benefit. Costs may be similarly estimated by identifying what people would be willing to pay to avoid a problem. For example, the cost of double glazing a house to avoid road noise or the higher

value of housing located on a minor road compared with a nearby major road may provide a partial indicator of the costs of noise and air pollution. Proxy measures may also provide a partial indicator of costs and benefits.

Some techniques for quantifying the impacts of options are discussed in more detail in appendix B.

### *Discounting*

In formal cost-benefit analysis, dollar estimates of each option's expected costs to the community are subtracted from the expected benefits to arrive at a single figure for the option's expected net benefit (or cost).

However, where the costs and benefits associated with an option accrue over time, they cannot simply be combined without adjustment. This is because the community is not indifferent to the timing of costs and benefits. Benefits received now are worth more than those received in the future. Another way of looking at this issue is that, if people have some money now, they would not be willing to invest it unless they received their original funds plus some interest back in the future. Similarly, the community would prefer to defer any costs associated with an option to the future, rather than pay for them now.

This weighting of costs and benefits over time involves 'discounting'. The discount rate chosen may have a significant impact on the calculated net present value of an option and should therefore be selected carefully. For this reason, the OBPR recommends sensitivity analysis be undertaken to determine if changes in the discount rates have a significant or appreciable impact on the net benefit of different options. (See appendix B for more information on discounting costs and benefits in cost-benefit analysis.)

If you are not able to undertake a formal cost-benefit analysis because the main impacts of your proposal cannot be quantified, the notion that future benefits are less valuable than current benefits, and future costs are less of a burden than current costs, should still be incorporated in the qualitative assessment of net benefits.

### *Sensitivity analysis*

Often a range of reasonable assumptions could be used in an impact assessment, and individual judgements will vary as to what constitutes best estimates.

In this situation, a sensitivity analysis should be undertaken to show transparently how differences in such judgements, or uncertainty, affect the outcomes of cost-benefit analysis or qualitative impact assessment.

Sensitivity analysis involves altering some critical assumptions and, in a formal cost-benefit analysis, recalculating the estimated net present value for these different scenarios (such as 'best case', 'most likely' or 'worst case') to gauge the range of impacts reasonably associated with an option.

This assists in determining which assumptions are critical to determining the net benefit of different options and the robustness of estimated net benefits. The results of sensitivity analysis should be included in the RIS. (See appendix B for more information on undertaking sensitivity analyses.)

*Risk analysis*

Many of the problems that give rise to regulation involve the risk of hazards or adverse events. In these cases, the aim of regulation is typically to reduce the likelihood or frequency of the hazard materialising, or to reduce the consequences if it does occur (and to achieve this at least cost).

If the aim of regulation is to address a hazard, risk analysis should be conducted to establish the effect each option would have in altering the likelihood, frequency or consequences of the adverse event occurring. This information is needed to assess the potential benefits of each option. (See appendix C for an introduction to risk analysis.)

### 6.4.5 Quantify the compliance costs on business

Consideration should be given to the compliance burden imposed on business. These are the additional (incremental) costs incurred by businesses when complying with regulations. To estimate the incremental change in compliance costs resulting from a proposed regulatory change, it may also be appropriate to consider how the change impacts on particular types of business (for example, according to firm size, scale of operations and/or location).

These compliance costs may be either one-off or ongoing. These are explained in more detail in box 6.9.

Box 6.9 **The importance of compliance costs**

The consideration of compliance costs in a RIS is important because such costs can:

- divert businesses' energy and resources away from core business activities;
- diminish the viability of businesses;
- have a particularly adverse impact on small businesses;
- create an environment of regulatory uncertainty and risk; and
- be passed on to consumers through higher prices, with possible distributional and equity consequences.

Compliance costs can usually be divided into two broad categories:

- *one-off costs* — such as acquiring sufficient knowledge to meet regulatory obligations, purchasing/leasing additional equipment and buildings, legal/consultancy fees and training expenses; and
- *recurring and ongoing costs* — such as monitoring processes to ensure ongoing compliance, preparing periodic reports to a regulator, undertaking audits or inspections (that is, costs arising from the ongoing need to devote additional time and resources to satisfying regulatory requirements).

The Government has mandated the quantification of compliance costs for all proposals that will impose medium or significant compliance costs on business. If a policy officer is preparing a RIS and believes that there will be no or low compliance costs, the OBPR can confirm this assessment and whether compliance costs must be quantified in the RIS.

The BCC is the primary tool to be used for estimating compliance costs. Other methods can be used provided they will give an accurate estimation of compliance costs and the policy officer seeks approval from the OBPR (this can be done when an initial draft of the RIS is sent to the OBPR for comment).

More information about the BCC is contained in part 3 and appendix D.

The results of the quantitative assessment of compliance costs must be incorporated into the RIS and should clearly show:

- the upfront (or start-up) compliance costs of the proposal (both as a whole and per business);
- the ongoing (or yearly) compliance costs of the proposal; and
- all assumptions and data sources used in generating these estimates.

Where the compliance costs fall disproportionately on particular groups of businesses, this should also be highlighted and discussed.

A simple example of the type of information that may be needed to estimate the compliance costs of a regulatory option is provided in box 6.10.

### 6.4.6 Examine the effect of each option on individuals, and on the cumulative burden on business

Options may impose compliance cost burdens on individuals as well as businesses, and many of the intended beneficiaries of a proposal will also be individuals. The impact on any one individual may be difficult to quantify. However, impacts on individuals may be captured by considering groupings such as consumers, families or local communities. If the costs cannot be quantified, they may be described qualitatively, allowing a comparison of the options for dealing with a perceived problem.

Consideration must also be given to the contribution that the proposed option would make to the overall burden of regulation on businesses, individuals and the community. This is often referred to as the cumulative burden. When a new requirement is added to the existing stock of regulations, the effectiveness of other regulations may be reduced. This may occur simply due to the overall volume of regulations and requirements that exist — there is a limit to the number of regulations that business can comply with fully, just as there is a limit to the number of regulations that departments or agencies can enforce fully or effectively.

The RIS should examine the cumulative regulatory burden. When considering changes to regulation, officials should demonstrate that they have sought to:

- reduce the existing burden of regulation;
- minimise any overlapping effects of new and existing regulation; and
- justify any incremental increase in the cumulative burden of regulation.

Box 6.10 **Example: Estimating the compliance costs of regulation**

A hypothetical regulatory option could require all clothing manufacturers to use a prescribed form to report on the number and type of people they employed at 1 July each year. The BCC should be used to calculate the compliance costs of this regulatory option.

Most businesses would already have employment information as part of their normal record-keeping requirements. Therefore, the compliance cost for each business would include a one-off cost of training staff to complete the form (assuming no staff turnover); and ongoing costs of the additional staff time needed to extract the relevant information from existing business records, complete the prescribed form and transmit it to the regulator each year.

Reference to existing statistical information, consultation with business and targeted research might indicate that the number of businesses affected and the additional staff time needed to complete the tasks for each type of business are as follows.

| *Size of business* | *Number of businesses* | *Time to complete one-off tasks* | *Time to complete ongoing tasks* |
|---|---|---|---|
| Small | 30 000 | 30 mins | 20 mins |
| Medium | 3 000 | 30 mins | 30 mins |
| Large | 500 | 30 mins | 40 mins |

These sources might also indicate that average clerical wages and on-costs in this sector are $24 per hour. Using this information, the BCC would estimate total compliance costs as follows.

| *Size of business* | *One-off costs ($'000)* | *Ongoing tasks ($'000)* |
|---|---|---|
| Small | 360 | 240 |
| Medium | 36 | 36 |
| Large | 6 | 8 |
| All businesses | 402 | 284 |

This example — with estimates for the sector of $402 000 for one-off compliance costs and $284 000 a year for additional ongoing compliance costs — shows that even small increases in compliance costs for individual businesses can result in significant increases in business costs.

### 6.4.7 Identify the data sources and assumptions used in making these assessments, and any gaps in data

Data sources and assumptions made when conducting the impact analysis should be included in the RIS so that the reasoning behind the conclusions is open to scrutiny.

This applies to both quantitative and qualitative information included in the impact analysis. In the case of quantitative information, it should be possible to cite specific sources, and explain how data were derived from those sources. Where qualitative assessments of costs and benefits are included, the RIS should explain the empirical evidence and reasoning on which they are based. All assertions and conclusions in the RIS should be based on evidence.

The RIS should clearly flag any gaps in the data underpinning the analysis, or assumptions that have been made. If there is significant uncertainty about any key data inputs, the RIS should include a sensitivity analysis that considers outcomes for a range of values (see the discussion of sensitivity analysis under section 6.4.4).

### 6.4.8 Summarise outcomes for each option examined

An outline of the main assumptions underlying the assessments, and key variables that affect results, should be repeated here.

This information could be presented in a table (see table 6.1) listing each alternative option examined and the main results.

Table 6.1 **Template summary table of impacts by option**

Primary objective: *[As identified in section 2 of the RIS]*

Secondary objective(s): *[As identified in section 2 of the RIS]*

| ***Option*** | ***Impacts, costs and benefits*** | | | ***Overall impacts*** |
|---|---|---|---|---|
| (non-regulatory and regulatory) | **Business**<br>(small, medium and large) | **Government**<br>(Australian Government, state/territory, local governments) | **Other stakeholder groups**<br>(e.g. consumers, employees, recreational fishers) | (Net of transfers) |
| **Option A** (relative to status quo) | Benefits<br>Costs<br>Change in compliance costs as estimated by the BCC | Benefits<br>Costs<br>Administrative costs/savings | Benefits<br>Costs (including any compliance costs) | Net benefits<br>Key assumptions underlying net benefit estimates |
| Other information relevant to the analysis | | | | |
| **Option B** (relative to status quo) | Benefits<br>Costs<br>Change in compliance costs as estimated by the BCC | Benefits<br>Costs<br>Administrative costs/savings | Benefits<br>Costs (including any compliance costs) | Net benefits<br>Key assumptions underlying net benefit estimates |
| Other information relevant to the analysis | | | | |
| **Option C** (relative to status quo) | Benefits<br>Costs<br>Change in compliance costs as estimated by the BCC | Benefits<br>Costs<br>Administrative costs/savings | Benefits<br>Costs (including any compliance costs) | Net benefits<br>Key assumptions underlying net benefit estimates |
| Other information relevant to the analysis | | | | |

## 6.5 Consultation

Consultation with affected parties is a key requirement of the RIS process.

In general, any policy development process, including proposed new regulation or changes to regulation, should involve consultation with relevant stakeholders — including business, the community, regulators and other government agencies.

Consultation on regulatory options can improve the quality of the solution adopted by:

- ensuring that both those affected by regulation and the actioning agency have a good understanding of what the problem is;
- providing perspectives and suggestions on alternative options to address the problem from those parties that will be affected by the government action;
- helping regulators assess competing interests;
- providing a check on the regulator's assessment of costs (including compliance costs) and benefits and whether/how the proposed option will work in practice, thus reducing the risk of unintended consequences if a particular option is adopted;
- identifying interactions between different types of regulations; and
- possibly enhancing voluntary compliance through greater understanding and acceptance of a proposal, thereby reducing reliance on enforcement and sanctions.

The Australian Government has adopted a whole-of-government consultation policy. This policy is based on the seven principles for best practice consultation — continuity, targeting, appropriate timeliness, accessibility, transparency, consistency and flexibility, and evaluation and review. These principles, discussed in part 4, must be applied to consultation undertaken as part of the RIS process. The nature of consultation should be commensurate with the potential impact of the problem and proposed regulatory solution. If you need guidance in relation to a specific proposal, contact the OBPR.

A consultation statement should be incorporated into a RIS.[2] This will document the outcomes of the consultation, as well as the application of the whole-of-government consultation principles in the consultation process. The statement should include the following.

[2] For legislative instruments, the RIS will satisfy requirements in the *Legislative Instruments Act 2003* for consultation statements.

### 6.5.1 Who are the main affected parties? Who has been consulted?

The consultation statement should identify the main parties affected and who has been consulted.

### 6.5.2 What are their views?

It is important to identify the views of stakeholders. Areas of agreement, as well as areas of difference, should be noted. It is important to document dissenting views. The RIS should also include information on intergovernmental consultation, if relevant, and indicate whether consensus has been achieved.

### 6.5.3 How have stakeholders' views been taken into account?

Government policy is to ensure that those affected by proposed regulation are consulted at an early stage of the development of the regulation, with comments received in response to consultation to be taken into account in determining the most appropriate regulatory option.

The RIS should document how the proposal has been modified to take account of stakeholders' views. If the proposal has not been modified, the RIS should explain why dissenting views have not been accepted.

### 6.5.4 What was the consultation process?

The consultation statement should also identify the process used for consultation (that is, the application of the whole-of-government consultation principles). The discussion of the process should cover:

- the consultation objective (for example, to obtain stakeholders' views on the policy proposal and policy options or to obtain stakeholders' views on regulatory design and implementation);
- the stages of the policy development process at which consultation was undertaken (for example, identification of policy objectives and draft RIS stages) and the time frames given;
- the nature of the consultation (for example, public meetings and a call for written submissions); and
- the methods by which consultation was publicised and information about proposals provided (for example, the business consultation portal,

advertisements in industry newsletters and placing the draft RIS on the agency website).

### 6.5.5 Where consultation was limited or not undertaken, why was full consultation inappropriate?

There are circumstances where full consultation may be inappropriate (for example, in the context of budget proposals, tax anti-avoidance measures, or matters of national security). Where consultation was not undertaken or where consultation was limited, reasons why full consultation was not undertaken should be given.

## 6.6 Conclusion and recommended option

### 6.6.1 What is the preferred option? Why is this option preferred and others rejected?

This section should provide a brief summary of each option. The reasons for deciding to proceed with a particular option, how the community is expected to obtain a net benefit, and why the preferred option is the best option, should be explicitly stated, as should the reasons for rejecting other options. Areas of uncertainty should be highlighted, particularly if they may have a significant impact on expected outcomes. No new information should be introduced.

As adoption of most options will involve making trade-offs among different attributes, it is important to indicate the main assumptions that support adoption of the preferred option. These should be briefly stated, particularly if they may have a significant impact on expected outcomes. This allows for checking and refining of the analysis. The effect of varying critical assumptions should also be included.

## 6.7 Implementation and review

Having established which option is most likely to effectively and efficiently meet the objectives stated at the beginning of the RIS, it is necessary to consider how the option will be implemented and enforced, and to establish a review strategy that will allow the option to be evaluated after it has been in place for some time.

This section should indicate how the preferred option will be implemented and reviewed, when it will be reviewed and what the review process will involve.

### 6.7.1 How will the preferred option be implemented?

It is important to consider some practical implementation issues (if they have not yet been considered) before the option is adopted. These include:

- administrative issues, such as which authority will administer the option proposed and how it will function;
- actions regulated parties are required to take, such as maintaining extra information, completing forms, or proving experience, expertise or educational achievements;
- identifying the departments and agencies that will have a role in implementing or enforcing the proposal — resource requirements and costs should be estimated;
- information required to administer the preferred option and whether it duplicates existing requirements — opportunities for rationalisation should be examined (for example, by establishing one-stop-shops to collect, or dispense, information for several departments or /agencies);
- transitional arrangements to minimise the impact on stakeholders, for example delayed or gradual introduction of new requirements, and provision of information and other assistance to businesses affected; and
- how the option would be enforced (including the resourcing of enforcement).

In some cases, alternative compliance and enforcement strategies should be identified. These can include:

- administrative versus civil versus criminal sanctions;
- corporate versus director liability;
- the desirability of risk-based enforcement strategies; and
- the desirability of enforcement pyramids (for example, warnings for initial or low-level breaches, fines for subsequent and/or high-level breaches, leading to licence suspension or revocation as ultimate sanctions).

### 6.7.2 Is the preferred option clear, consistent, comprehensible and accessible to users?

This principle simply ensures that the mechanism will be understood by those who are affected by it. In the case of legislation, clear expression may also help highlight areas of inconsistency or duplication with existing regulations. Clarity can also aid compliance as complex requirements are difficult to comply with and difficult to enforce. It may be useful to consider whether every possible detail and circumstance

needs to be set out in the requirements. Some level of discretion for those enforcing the requirements, coupled with clear guidance on what will be regarded as complying behaviour and what will not, should go some way to improving the clarity of regulation and requirements.

### 6.7.3 Is the preferred option sufficiently flexible to adapt to various situations and circumstances?

If legislation is adopted, it should be drafted in a way that makes it sufficiently flexible to take into account the different impacts it will have on those being regulated. Performance-based regulation may be used to achieve this end. (For example, see the sub-section 'Standards' (including voluntary and regulatory standards) in appendix A). At the same time, the regulation should be applied fairly and equitably. For instance, importers should be subject to the same labelling requirements as domestic producers. Consideration may be given, where appropriate, to having built-in authority to waive or modify the regulation in certain circumstances, and provide for an adequate review or appeal process for decisions made.

### 6.7.4 How will the preferred option interact with existing regulation of the sector?

New proposals must co-exist with the existing stock of regulations and requirements. To ensure that proposed regulation does not conflict with or duplicate existing regulations and requirements, it is important to examine how the preferred option will interact with existing regulation.

This is particularly applicable to those in Australian Government regulatory bodies because the proposed solution may conflict with, or duplicate, existing regulations and requirements imposed by state/territory and/or local governments. Similarly, it may highlight areas where national consistency of requirements would be most suitable.

### 6.7.5 What is the impact on business, including small business, and how will compliance and paper burden costs be minimised?

The compliance costs of each option will have been assessed in the *Impact analysis* section. If there are ways to reduce or minimise the compliance costs associated with the preferred option, they should be discussed and estimated using the BCC. In addition, any trade-offs between compliance costs and administrative costs of

government, such as the costs of implementing and monitoring regulations, should also be explicitly identified.

### 6.7.6 How will the effectiveness of the preferred option be assessed? How frequently? Is there a built-in provision to review or revoke the regulation after it has been in place for a certain length of time?

This section should state how the preferred option will be monitored to assess its progress in achieving its objectives, and how it can be amended or abolished when the circumstances which led to its introduction change. Are there ongoing arrangements for consulting with stakeholders affected by implementation of the preferred option? If so, who will be responsible for managing these arrangements?

When the option has been in place for some time and is being reviewed, the department or agency should consider key issues such as the following.

- Is there still a problem?
- Are the objectives being met?
- Were the impacts as expected? Have unforeseen problems occurred? Are there indirect effects that were not anticipated?
- Is action still required? Is this still the appropriate action to take or would another measure be more appropriate? Does experience with the measure suggest ways it can be improved to meet the objectives?

In addition to conducting a full review of regulation after it has been in place for some time, measures for ongoing review might include:

- establishing a complaints-handling or feedback mechanism and/or a point of contact for queries;
- establishing arrangements for ongoing consultation with groups affected;
- providing for regular reporting to the public, such as through a department or agency annual report; and/or
- inserting a review or sunset clause in the legislation.

A sunset clause results in the legislation expiring after a certain time, for example, five years. Prior to expiry, the regulation can be reviewed and re-enacted if it is still required. Sunset clauses can be an effective means of keeping the overall burden of regulation on the community at an acceptable level, and of reducing the number of outdated regulations still in force.

A sunset clause is particularly suitable for regulation that has been established to deal with an unexpected emergency or with temporary problems, such as measures aimed at providing drought relief.

Where sunset clauses are not used, and the regulation has no statutory or built-in review requirement, the RIS should note that the regulation will be reviewed under the Government's five-yearly review requirements (see part 2).

# A Forms of regulation and alternatives

In the past, much regulation tended to involve a prescriptive approach. However, governments around the world, including in Australia, are moving away from these approaches to more innovative methods of dealing with identified problems. These alternative methods can be less costly, more flexible, and therefore more effective than prescriptive regulation.

The forms of regulation and alternatives are listed in box A.1. In some cases, a mix of alternatives may be most suitable.

Box A.1 **Forms of regulation and alternatives**

**Forms of regulation**

- self-regulation;
- quasi-regulation;
- co-regulation; and
- explicit government regulation (black letter law)

**Alternative instruments**

- no specific action;
- information and education campaigns (including labelling requirements or media campaigns);
- market-based instruments (including taxes, subsidies and user charges);
- tradeable property rights (marketable rights);
- pre-market assessment schemes (such as listing, certification and licensing);
- post-market exclusion measures (such as bans, recalls, licence revocation provisions and 'negative' licensing);
- codes of conduct or practice (including service charters);
- standards (including voluntary and regulatory standards); and
- other mechanisms, such as public information registers, mandatory audits and quality assurance schemes.

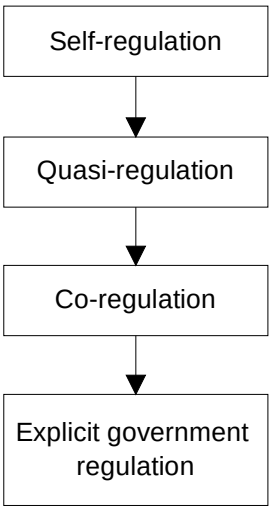
In all cases, the methods adopted to deal with a perceived problem should ideally have the following characteristics:

- administrative simplicity;
- flexibility; and
- efficiency and equity.

## A.1 Alternative forms of regulation

The principal forms of regulation may be viewed as part of a continuing spectrum of regulation — from self-regulation to explicit government regulation — as illustrated in figure A.1. The principal regulatory forms have various characteristics, advantages and disadvantages, such as their cost-effectiveness, flexibility, responsiveness, accessibility and level of scrutiny, all of which are important in assessing which form might be best for addressing a particular problem.

Figure A.1 **A simplified spectrum of regulation**




### Self-regulation

Self-regulation is generally characterised by industry formulating rules, standards and codes of conduct, with industry solely responsible for enforcement (see box A.2). In some cases, governments may also be involved in a limited way, for example, by providing advisory information.

Box A.2 **Example: Advertising self-regulation system**

The advertising self-regulatory system, now managed by the Advertising Standards Bureau and funded voluntarily by the industry through the Australian Advertising Standards Council, recognises that advertisers share a common interest in promoting consumer confidence in and respect for general standards of advertising.

The Advertising Standards Bureau administers this national voluntary system of advertising self-regulation through the Advertising Standards Board and Advertising Claims Board.

The Advertising Standards Board provides a free complaint resolution service. It provides determinations on complaints about most forms of advertising in relation to issues including the use of language, the discriminatory portrayal of people, concern for children, portrayals of violence, sex, sexuality and nudity, and health and safety.

The Advertising Claims Board deals with complaints involving issues of truth, accuracy and the legality of advertising on a user-pays cost recovery basis.

Both boards make their determinations under appropriate sections of the Advertiser Code of Ethics, as prescribed by the Australian Association of National Advertisers.

Self-regulation of the Australian advertising industry is funded by a voluntary levy paid by responsible advertisers and collected through advertising agencies.

*Source:* Advertising Standards Bureau, http://www.advertisingstandardsbureau.com.au

The Government requires that self-regulation be one of the first options considered in reviews of regulation and in Regulation Impact Statements (RISs).

Self-regulation usually implies that firms in an industry or members of a profession have accepted mutual obligations. These obligations are often described in a code of conduct or practice. Self-regulation is common among the professions and in the financial sector.

Typically, under these arrangements, an organised group regulates the behaviour of its own members. As the rules are made by people in the industry being regulated, they may be more likely to be observed. They can also be updated more quickly and can incorporate the expertise of those being regulated.

However, there may be a need to oversee self-regulation to ensure that the community benefits. Sometimes rules are designed to protect or confer commercial advantage on one group over another group, exclude new entrants to an industry, fix prices or limit competition.

By contrast, imposing minimum standards may sometimes reduce the ability of consumers to choose lower-cost and/or lower-quality products and services.

These issues need to be considered and assessments made of the restrictions on competition and consumer choice that may arise from particular schemes.

Another potential problem is obtaining industry compliance and coverage. Self-regulation may be difficult to enforce due to the lack of legal sanctions. In these circumstances, 'free-riders' often benefit from the existence of industry arrangements without themselves complying. However, there may also be greater scope for innovative sanctions to be developed and applied by those closely involved in the industry.

The checklist in box A.7 sets out situations where self-regulation is likely to be a suitable and successful approach.

## Quasi-regulation

As well as establishing regulation explicitly through legislation, governments also achieve regulatory ends by putting pressure on businesses to comply with rules that may not be legally binding. These types of arrangements are referred to as 'quasi-regulation'.

Quasi-regulation includes a wide range of rules or arrangements where government influences business to comply, but which do not form part of explicit government regulation. Broadly, whenever government takes action that puts pressure on businesses to act in a particular way, the government action may be quasi-regulatory.

Some examples of quasi-regulation include government-endorsed industry codes of practice or standards, government-issued guidance notes, industry–government agreements and national accreditation schemes.

The involvement by government in quasi-regulation, whether through official endorsement, representation on monitoring committees, provision of funding or other help to industry, can enhance industry compliance with the particular code, standard or arrangement.

There are a number of specific ways in which government may encourage compliance with quasi-regulatory rules. These include:

- endorsing, promoting or being directly involved in industry-based regulation such as codes;
- threatening binding regulation in the event of non-compliance with a voluntary arrangement;

- establishing legislative underpinning for voluntary arrangements to give them greater force;
- negotiating agreements on behaviour directly with industry;
- issuing guidelines that elaborate on mandatory requirements in a context where non-compliance may pose enforcement risks for businesses; and
- making compliance with codes or standards a precondition for involvement in government contracts or other government benefits.

Quasi-regulation, as with self-regulation, can offer advantages in the form of greater flexibility and responsiveness, less cost to government and greater collaboration with industry, particularly in cases of industry-initiated schemes. Greater compliance is possible if rules are clear and designed in collaboration with industry experts. Quasi-regulation can sometimes also make use of innovative compliance mechanisms and quicker, cheaper dispute resolution schemes. Due to greater involvement and ownership, industry may also be more willing to contribute resources to developing, implementing and enforcing this form of regulation.

For more guidance on quasi-regulation, refer to the Commonwealth Interdepartmental Committee Report on Quasi-regulation, *Grey-Letter Law* (CICQ 1997).

Examples of quasi-regulation are provided in boxes A.3 and A.4.

The checklist in box A.7 sets out situations where quasi-regulation is likely to be a suitable and successful alternative.

Box A.3 **Example: Electronic Funds Transfer Code of Conduct**

The Electronic Funds Transfer Code was introduced in 1986 and originally applied to financial transactions effected through the use of a card and a personal identification number. Industry, consumer and government representatives contributed to the development of the code, which was endorsed by the Commonwealth, state and territory governments.

In 2002 the Code was expanded to cover all types of electronic funds transfers, including telephone and internet banking, credit card transactions and stored value facilities. The Code sets out rules on matters such as provision of information to users, liability for unauthorised transactions, complaint procedures, protection for users of stored value facilities and privacy.

While the Code is voluntary, a wide range of financial institutions have signed up to it.

Box A.4 **Example: National Code of Practice for the Construction Industry**

This code was developed jointly by the Australian Procurement and Construction Council and the Department of Workplace Relations Advisory Committee.

The Code is a set of principles that describe good practice in respect of workplace relations, occupational health and safety, procurement and security of payment in the construction industry. Sanctions for breaches include partial or total exclusion from government work, publication of details of the breach or referring of the breach to other relevant authorities.

In endorsing the Code, the Australian, state and territory governments indicated they were using their position as major clients of business to encourage changes in industry production processes so as to raise productivity, and to take other action that will help develop an industry that achieves internationally competitive standards.

## Co-regulation

Co-regulation usually refers to the situation where industry develops and administers its own arrangements, but government provides legislative backing to enable the arrangements to be enforced. This is known as 'underpinning' of codes or standards. Sometimes legislation sets out mandatory government standards, but provides that an industry code can override those standards. Legislation may also provide for government-imposed arrangements in the event that industry does not develop arrangements of its own. An example is provided in box A.5.

There are a variety of ways in which government may provide legislative support to industry-based codes (or standards), including:[1]

- delegating power to industry to regulate and enforce codes;
- enforcing undertakings to comply with a code;
- incorporating a reserve power to have a code;
- requiring industry to have a code but, in its absence, government may impose a code; and
- prescribing industry codes as voluntary or mandatory.

Although co-regulatory arrangements are usually designed by industry, a RIS is still required to demonstrate that the best option has been chosen. The relevant

1 For further information see Minister for Customs and Consumer Affairs 1998.

government department, agency, statutory authority or board should prepare the RIS in consultation with the industry.

Box A.5 **Example: Telecommunications consumer protection regime**

Telecommunications legislation provides that industry may have the responsibility for developing and implementing codes of practice for consumer protection matters, such as the internal handling of customer complaints and the timeliness and comprehensibility of bills.

If industry fails to develop adequate codes, the Australian Communications and Media Authority has the power to either request that a code be developed by industry in a given time frame, or develop a 'standard' that is binding on industry. Compliance with these codes is voluntary, but the Authority has the power to direct a particular participant to comply (where the Authority has registered the code).

The legislation also permits codes to confer power on the Telecommunications Industry Ombudsman to handle customer complaints about breaches of the code.

In 1997 the *Trade Practices Act 1974* (TPA) was amended to allow prescription of an industry or consumer code, or relevant provisions of such codes, as either mandatory or voluntary (see box A.6). The Government also decided that a number of prerequisites must be met before prescription of codes under the TPA can proceed, including the following.

- A market failure has been identified that will, in the absence of government intervention, have a significant detrimental impact on a substantial group in the community. Alternatively, where there is a social policy objective that, if not pursued by government, will lead to a significant detrimental impact on a substantial group in the community.
- A systemic enforcement issue exists, for example, breaches of voluntary industry codes and lack of agreement on fair trading principles, which has led to the failure of self-regulatory or quasi-regulatory arrangements.
- There are significant deficiencies in any existing regulatory regime that cannot be remedied (for example, inadequate industry coverage).
- A range of self-regulatory options and 'light-handed' quasi-regulatory options have been examined and demonstrated to be ineffective.

A comprehensive RIS will be required for any code that is under consideration for prescription under the TPA. Draft RISs must be distributed as part of the consultation with affected parties.

Box A.6 **Example: Codes of practice under the *Trade Practices Act 1974***

The TPA allows prescription of an industry or consumer code, or relevant provisions of such codes, as either mandatory or voluntary. A mandatory code can be enforced on all businesses in the specified industry, regardless of whether they are signatories to the code. A voluntary code can be enforced only on those businesses that are signatories.

Prescription applies the remedies contained in the TPA to those who contravene such codes. A feature of prescribed codes is that they retain a high degree of industry involvement, while providing the enforceability and coverage that can be ensured only through legislative means.

## Advantages and disadvantages of self-regulation, quasi-regulation and co-regulation

Overall, there can be a number of potential *benefits* associated with self-regulation, quasi-regulation and co-regulation compared with explicit government regulation. These include:

- lower government administration costs, because such arrangements are developed and often administered by business;
- lower compliance costs for business;
- innovative inducements for compliance and sanctions for non-compliance;
- rules that are tailored to specific needs and thus better targeted;
- improved credibility because rules are developed by business, not imposed by governments;
- enhanced flexibility, responsiveness and speed of implementation and modification; and
- greater responsiveness to consumer demands based on additional information gained from, for example, the complaints mechanism.

The potential *costs* of self-regulation, quasi-regulation and co-regulation can include:

- creation of restrictions on competition (for example, barriers to entry, restrictions on advertising, prescribed prices);
- reductions in consumer choice, by creating minimum standards that do not allow consumers to choose lower-cost/quality products or services;

- creation of expectations of compliance by governments and consumers, which are not met when some businesses do not comply;
- ineffective sanctions for non-compliance;
- creation of confusion about regulatory requirements; and
- costs to businesses to develop or administer quasi-regulatory schemes.

## Potential problems associated with the implementation of quasi-regulation

It is important to note that some of the potential problems associated with quasi-regulation sometimes are created by the way governments formulate or implement quasi-regulations, and therefore can be avoided. Such problems that can be avoided could include:

- governments are often inconsistent in their choice of regulatory forms and there is a often a lack of government justification and impact analysis for quasi-regulation;
- quasi-regulation gives much discretion to regulators and, because of its convenience and lack of scrutiny, is sometimes used as 'backdoor regulation';
    - what starts out as self-regulation can gain the imprimatur of government agencies and subsequently be lifted into legislation, which is depicted by some as 'regulatory creep';
    - quasi-regulation may be pitched at best practice standards rather than minimum effective regulation, imposing an unnecessarily high compliance burden on business;
    - small business often lacks the resources and expertise to operate successfully under performance-based regulation and may fear greater litigation from such arrangements, preferring the certainty offered by prescriptive regulation;
    - confusion exists about the status and enforceability of many quasi-regulatory arrangements (quasi-regulation is often less accessible than Acts of Parliament and some businesses may not comply with quasi-regulation because they judge that full compliance is impossible or impractical); and
    - quasi-regulation can result in a shifting of costs to industry because of the substantial resources involved in developing and administering industry-based schemes.

When reviewing, reforming and implementing quasi-regulations, governments should be aware of these potential problems, and take steps to avoid them.

## Explicit government regulation (black letter law)

This type of regulation has three main characteristics: it attempts to change the behaviour of groups or individuals by detailing how regulated entities should act; it generally relies on government inspectors and/or monitoring to detect non-compliance; and it imposes punitive sanctions, such as fines, if the regulations are not complied with. This approach establishes clear and standardised rules and can be successful in addressing well-defined and stable problems.

Explicit government regulation is often considered to offer more certainty, including industry-wide coverage, and greater effectiveness compared with other forms of regulation because of the availability of legal sanctions. It is often preferred by regulators, particularly in dealing with high-impact, high-risk public issues. In some circumstances, compliance costs might be lower for legislation because of greater certainty.

However, explicit government regulation can have several potential drawbacks.

- It may be standardised and inflexible. This means that it may not adequately deal with diverse conditions or with changes over time. This can result in the regulation becoming outdated and even counter-productive. It may also impede technological progress and innovation.
- It may, over time, generate more and more regulation. For instance, more regulation is created to adapt the original regulation to a new situation or to close the gaps where compliance is not being achieved.
- There are potentially significant time lags inherent in making and amending legislation.
- Legislation may not be well suited for influencing the quality of complex services, such as those provided by many of the professions.
- The perception by some people that legislative drafting is complex and difficult to understand may deter some of them from trying to comply.
- Government budgetary costs are often higher with black letter law and there may be less accountability for administrative costs, compared with other regulatory forms that utilise the resources of commerce and industry.
- Compliance costs may be high as the law often does not reflect accepted commercial practices.
- Costs and delays associated with the justice system may mean poor access for those without means to pursue their legal rights.

## A.2 Choosing the best regulatory form

There are a variety of factors relevant to choosing the best regulatory form to address specific problems, including the severity of the problem; the extent of risk (where applicable); the nature of the industry concerned; the need for flexibility or certainty in regulatory arrangements; and the availability of resources.

A checklist to guide users through the selection of the different regulatory forms — self-regulation, quasi-regulation, co-regulation and explicit government regulation — is provided in box A.7.

Box A.7 **Checklist for the assessment of regulatory forms for their suitability**

**Self-regulation should be considered where:**

- there is no strong public interest concern, in particular, no major public health and safety concern;
- the problem is a low-risk event, of low impact or significance; and
- the problem can be fixed by the market itself. For example, there may be an incentive for individuals and groups to develop and comply with self-regulatory arrangements (industry survival, market advantage).

**The likelihood of self-regulatory industry schemes being successful is increased if there is:**

- adequate coverage of industry concerned;
- a viable industry association;
- a cohesive industry with like-minded or motivated participants committed to achieving the goals;
- evidence that voluntary participation can work — effective sanctions and incentives can be applied, with low scope for the benefits being shared by non-participants; and
- a cost advantage from tailor-made solutions and less formal mechanisms, such as access to quick complaints-handling and redress mechanisms.

However, care must be taken to ensure any proposed self-regulatory approaches are not anti-competitive, for example, do not restrict the entry of new market participants.

(Continued on next page)

Box A.7 **(continued)**

**Quasi-regulation should be considered where:**

- there is a public interest in some government involvement in regulatory arrangements and the issue is unlikely to be addressed by self-regulation;
- there is a need for an urgent, interim response to a problem in the short term while a long-term regulatory solution is being developed;
- government is not convinced of the need to develop or mandate a code for the whole industry;
- there are cost advantages from flexible, tailor-made solutions and less formal mechanisms, such as access to speedy, low-cost complaints handling and redress mechanisms; and
- there are advantages in the government engaging in a collaborative approach with industry, with industry having substantial ownership of the scheme. For this to be successful, there needs to be:

– a specific industry solution rather than regulation of general application;
– a cohesive industry with like-minded participants, motivated to achieve the goals;
– a viable industry association with the resources necessary to develop and/or enforce the scheme;
– effective sanctions or incentives to achieve the required level of compliance, with low scope for benefits being shared by non-participants; and
– effective external pressure from industry itself (survival factors), or threat of consumer or government action.

As in the case of self-regulation, proposed approaches should not restrict competition.

**Explicit government regulation should be considered where:**

- the problem is high risk and/or of high impact/significance, for example, a major public health and safety issue;
- the government requires the certainty provided by legal sanctions;
- universal application is required (or at least where the coverage of an entire industry sector or more than one industry sector is judged as necessary);
- there is a systemic compliance problem with a history of intractable disputes and repeated or flagrant breaches of fair trading principles, and no possibility of effective sanctions being applied; and
- existing industry bodies lack adequate coverage of industry participants, are inadequately resourced or do not have a strong regulatory commitment.

## A.3 Alternative forms of intervention

A range of alternative instruments can be used to achieve policy objectives. These alternative instruments are discussed here in detail.

### No specific action

Prior to considering the other alternatives, the option of not taking specific action should be considered. This option involves relying on the market in conjunction with existing laws.

There is a possibility that action will not improve the situation or, alternatively, that the problem may solve itself (as can happen when markets are changing rapidly) or may have been misunderstood. Government action may only shift the problem elsewhere, or the costs of government action may be greater than the costs imposed by the problem it is designed to correct.

In addition, it is useful to consider whether the problem may have been caused by a previous government action — this may point to areas of regulation that need to be removed, simplified or amended in order to remove the problem.

The department or agency proposing action should also consider whether existing regulations and requirements can be altered to achieve the objective sought.

Regulation is often designed to reduce risk, but if people are held responsible for their actions and are required to pay damages, usually incentives develop for people to take appropriate levels of care. By providing accessible legal remedies, individuals can enforce their rights rather than relying on government action to do so. In practice, however, legal remedy may sometimes be too uncertain, slow or costly to be an efficient method of changing behaviour.

The availability of insurance allows businesses and consumers to assess many risks and determine cost-effective ways to reduce them. Governments may establish or merely promote insurance schemes designed to protect certain people (for example, consumers) against specific risks. Governments may also require businesses to carry private insurance for specified risks as a condition of receiving permission to operate or carry out particular activities. In this second case, insurance is really a requirement of the regulatory regime rather than an alternative to it. An example is the requirement in Victoria for registered builders to take out builders warranty insurance. This is designed to protect clients of the builder against defects and incomplete work in cases where the builder is deceased, insolvent, or has disappeared.

### *Information and education campaigns*

These strategies seek to alleviate the problem by changing the quality of the information available, or its distribution. Examples include QUIT campaigns directed at smokers, environmental awareness programs and safe sex campaigns to prevent the spread of HIV and AIDS. These measures are intended to improve market functioning by allowing people to make better informed decisions.

The main advantage of these strategies over some other approaches is that they allow individuals to choose what is best for them given the information available, rather than imposing one solution on all.

This type of approach does not set legally binding rules on behaviour. Instead, objectives are reached through education and persuasion. This is most effective if the behaviour that needs to be changed occurs through ignorance. People may voluntarily change their behaviour if they are made aware of a problem or why a particular objective is being sought.

At times, the provision of information or education may be as effective as coercion for obtaining desired results. Appeals for individuals or companies to contribute to the public good, or to maintain a good (business) reputation, can be effective in changing behaviour. Similarly, attempting to educate the community of the need for change is another possible strategy.

Information can be disseminated through government action in two ways:

- by requiring companies to disclose information about certain features or attributes of their products to consumers; and
- through the government collecting and disclosing information to the public.

Under these approaches, there often is no attempt to monitor behaviour in order to impose sanctions on those who do not comply. Rather, advertising, training and the provision of advisory services are used to achieve policy objectives.

It should also be noted that the market itself often responds to fill information voids. Examples include product comparisons in magazines such as *Choice*, or the independent testing and assessment of cars by motoring associations.

### *Labelling requirements*

Labelling requirements are another way of disseminating information. They often appear on products that pose some risk of harm to users, but can also refer to country of origin or other information.

The benefits of labelling are that producers are required to reveal information to buyers that they might otherwise not reveal, for instance, the potentially harmful attributes of their products. This allows consumers to make more informed choices. Individuals, taking this information into account, will decide whether to consume the product or not. This is often preferable to placing a ban on the product, which imposes one solution on all consumers and does not account for different individual circumstances (for example, the product may pose less harm to some people).

Labelling requirements may well impose costs on businesses. These costs are often passed on to consumers in the form of higher prices for the product. Government also incurs costs in enforcing labelling requirements.

These costs may not be worthwhile if there are few benefits in labelling. Labelling may result in few benefits if the information is not desired by consumers; is not conveyed meaningfully (so that information is misunderstood); or if consumers do not read or take the information into account when they decide whether to consume the product.

### *Market-based instruments (taxes, subsidies and user charges)*

Economic incentives can be used in the design of a regulatory system in order to change behaviour (see box A.8 for an example). These instruments can be more efficient than prescriptive regulation because they allow individuals to make their own cost-benefit trade-offs in pursuing certain behaviour. Consequently, they may achieve desired regulatory outcomes more efficiently. However, the outcomes associated with these approaches may be less certain than those associated with prescriptive regulation.

Market-based instruments work by altering the costs and benefits of certain actions, thereby changing individuals' behaviour. For example, a tax will raise the cost of engaging in a certain activity, while a subsidy will lower it. User charges also raise the costs of certain activities.

Box A.8 **Example: Low-sulphur diesel excise differential**

Low-sulphur fuels deliver environmental and health gains through reduced emissions of hydrocarbons and oxides of nitrogen. Low-sulphur fuels are also likely to further reduce particulate emissions known to cause respiratory problems, and facilitate the broader adoption of greenhouse friendly engine technologies. The Australian Government regulates the sulphur content of fuels by setting national fuel standards.

In 2004, to encourage the uptake of low-sulphur diesel in anticipation of changes to the national fuel standards, the Government introduced a 2 cents a litre differential between the excise duty rates for ultra low-sulphur diesel fuel (diesel with a sulphur content not exceeding 50 parts per million) and high-sulphur diesel (and similar products).

*Source:* Australian Taxation Office, Excise Duty Rates (as at 1 November 2005).

These instruments can be useful in dealing with 'spillovers' from private activities where free markets lead to too little or too much production of a particular good or service.

These approaches achieve desired outcomes by setting the incentives at the right level and setting charges that reflect the true values of resources so that they are not over or under utilised. In practice, a gradual approach of moving charges in the right direction is often adopted, because it can be difficult to estimate the 'right' level of charges, and gradual adjustment gives markets time to adjust.

### *Tradeable property rights (marketable rights)*

These are government-issued permits granting property rights (for example, to a resource) that may be bought and sold in a market.

Tradeable property rights can be used as an alternative to issuing licences and permits to limit production or consumption.

Examples of one form of tradeable permits are water or air pollutant permits (see box A.9). As pollution cannot be reduced to zero because it would be too costly in terms of production and employment lost, a desired total level of a particular pollutant needs to be set as a ceiling. Once this level is defined, permits are issued that allow the holder to produce a certain share of the total.

By allowing trade in permits, those firms that find it easiest or least costly to reduce pollutants can do so and sell their excess permits to other firms that find it relatively more costly to reduce emissions.

This type of system achieves the desired reduction in overall pollution in a more cost-effective way than would a set reduction in pollutants for each firm in the sector.

*Codes of conduct or practice*

Codes are generally adopted and administered by the industry to which they relate, although they often complement government laws and regulations. Codes may deal with a range of issues such as membership eligibility; standards for processes, practices or products/services; and complaint-handling procedures. The advantages of codes are that they are industry-specific, flexible and can be quickly amended. Also, the industry is often best placed to police conduct.

Box A.9 **Example: The Hunter River Salinity Trading Scheme**

A scheme involving the use of tradeable salt discharge credits to manage saline discharges into the Hunter River was trialled between 1 January 1995 and 1 January 1996.

The scheme identified three different flow conditions in the river.

In periods of low flow (90 per cent of the time in an average year) the river is most vulnerable to the effect of discharges and no discharges were allowed. During high-flow conditions, discharges were allowed, provided the level of salinity in the river remained below acceptable levels. Individual discharge sources were allowed a share of this total salt load, depending on the number of 'discharge credits' held.

The total allowable salt load for the river was set at the load that may be discharged by all sources collectively without exceeding the river salinity limits. This was calculated with reference to acceptable salinity levels in the river and the contribution of diffuse sources.

Under flood conditions, licence holders were generally permitted to discharge without limit as the river is least sensitive to the effect of discharge at such times.

As part of the scheme, a formula was developed to determine the initial allocation of credits to those discharging into the Hunter River. A strict monitoring regime was established to ensure that the level of salinity in the river at any point did not exceed acceptable levels. In addition, trading rules were established and trading in credits was recorded.

The scheme achieved the desired outcomes, including managing water quality, and has continued to operate successfully since 1 January 1996.

*Source:* NSW Environment Protection Authority 2003, *Hunter River Salinity Trading Scheme*, http://www.environment.nsw.gov.au.

Codes may be voluntary or mandatory (covering all members). Voluntary codes may be more flexible than mandatory requirements, but outcomes may be more uncertain. If there is some involvement by government in the development, implementation or endorsement of industry codes, such codes are defined as quasi-regulation.

*Standards (including voluntary and regulatory standards)*

Voluntary standards are developed by Standards Australia (a non-government body) and other third parties. Voluntary standards, and other standards, are sometimes subsequently incorporated into regulations or are used as regulatory standards.

There are three main types of standards:

- principles-based;
- performance-based; and
- prescriptive.

Principles-based standards describe the objective sought in general terms and require interpretation according to the circumstances. Performance-based standards specify the desired outcome in precise terms, but allow individual organisations to determine how to achieve the outcome. Prescriptive standards specify the technical means for attaining the specified outcome. An example is provided in box A.10.

Where regulatory options under consideration involve the incorporation of standards, any reports, statements and RISs should examine the costs associated with particular standards, and demonstrate that they are the most effective way of achieving the relevant policy objective. In particular, departments and agencies should consider the costs of using standards that were not specifically designed for the problem at hand.

Standards should not be overly complicated or impose unnecessarily high compliance costs. They should only be used where they are the most effective and efficient way of achieving an objective.

Where a standard is incorporated into regulation, the regulation should *not* modify or change the standard, unless it can be clearly shown that modification or change is necessary to address the identified problem. Similarly, where modifications may be made to a standard that has been referenced in regulation, those modifications should *not* be automatically incorporated into regulation. That is, where regulation refers to a standard, it should explicitly refer to the type, characteristics and date the

standard was made. It should *not* refer to a standard in such a way that any modifications to the standard are automatically incorporated into regulation.

Box A.10 **Example: Principles-based, prescriptive and performance-based standards**

The objective of a standard may be to reduce to safe levels the exposure of workers to chemical fumes that are a by-product of a production process. This general description would be a principles-based standard.

A prescriptive standard might seek to achieve that objective by requiring companies to install specified ventilation systems to extract the fumes, thereby reducing the exposure of workers.

Under a performance-based standard, each company would be required to meet the objective of reducing workers' exposure to fumes. Companies could achieve this objective by adopting the approach that best suits their operations. For instance, a company could change the inputs used in the production process, or could modify the production process itself, so that the total amount of fumes produced is reduced to safe levels.

Provided that the objective is specified clearly enough so that companies must attain a minimum level of reduction in exposure before they are deemed to comply with the standard, an alternative approach may provide a more efficient means of obtaining the objective for the company. It may also produce a larger overall reduction in the exposure of workers to fumes.

Regulatory reviews may seek to achieve harmonisation of regulatory standards across national jurisdictions (for example, for product standards and service sector areas such as accreditation and recognition of professional qualifications). This is not to say that Australian regulations need be the same as prevailing international norms. However, where there are differences between the proposed Australian approach and international norms, the ramifications for business and individuals should be examined. For example, where a regulation is more stringent than international norms, this might lead to a cost disadvantage to Australian producers. Where a proposal is less stringent than international norms, this may confer a cost advantage, but it may lead to Australian goods and services being excluded from certain overseas markets.

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# B Cost-benefit analysis

The Australian Government is committed to the use of cost-benefit analysis (CBA) to assess regulatory proposals to encourage better decision making. A CBA involves a systematic evaluation of the impacts of a regulatory proposal, accounting for all the effects on the community and economy: not just the immediate or direct effects, financial effects, or effects on one group. It emphasises, to the extent possible, valuing the gains and losses from a regulatory proposal in monetary terms.

In principle, CBA measures the efficiency or resource allocation effects of a regulatory change. It adds the dollar value of the gains and losses for all people affected. If the sum is positive, the benefits exceed the costs and the regulatory proposal would increase efficiency.

CBA is useful because it:

- provides decision makers with quantitative information about the likely effects of a regulatory proposal;
- encourages decision makers to take account of all the positive and negative effects of a regulatory proposal, and discourages them from making decisions based only on the impacts of a single group within the community;
- quantifies the impact of regulatory proposals in a standard manner, which promotes comparability, assists in the assessment of relative priorities and encourages consistent decision making;
- captures the various linkages between the regulatory proposal and other sectors of the economy (for example, increased safety may reduce health care costs), helping decision makers maximise net benefits to society; and
- helps discover cost-effective solutions to policy problems by identifying and measuring all costs.

Even when it is difficult to estimate some costs or benefits with precision, CBA makes clear and transparent the assumptions and judgements made. Further, attempting to quantify costs and benefits encourages these factors to be more closely examined.

This appendix provides an introduction to issues related to CBA of regulatory proposals. Policy officers can refer to a comprehensive guide to CBA, such as the

Australian Government's *Handbook of Cost-Benefit Analysis*, for more detail and guidance.

Most CBA guides concentrate on infrastructure projects, where the costs and benefits are relatively easy to measure. Here, the focus is on issues specific to the CBA of *regulatory* proposals, where the impacts are more difficult to quantify. Guidance is also provided on issues, such as discounting, to save duplication of effort each time a CBA is done and to promote consistency within government.

Topics covered include an introduction to the steps undertaken in preparing a CBA (as set out in box B.1); how to deal with costs and benefits that are difficult to measure; taking equity effects into consideration; determining the social discount rate; and some common CBA pitfalls.

Box B.1 **Steps in preparing a full cost-benefit analysis**

1. Specify the set of policy options.
2. Decide whose costs and benefits count.
3. Catalogue the impacts and select measurement indicators.
4. Predict the impacts over the life of the regulatory proposal.
5. Monetise (attach dollar values to) impacts.
6. Discount costs and benefits to obtain present values.
7. Compute the net present value of each policy option.
8. Perform sensitivity analysis.
9. Rank the policy options.

*Source:* Boardman et al. 2006

More information and assistance on preparing CBAs can be obtained from the CBA Unit within the OBPR — email cba@obpr.gov.au or visit the website (www.obpr.gov.au). Additional guidance and information on CBA is available on the OBPR website, and through training and other technical support.

## B.1 The major steps in cost-benefit analysis

Conducting a well-executed CBA requires policy officers to follow a logical sequence that matches the steps involved in a Regulation Impact Statement (RIS). This section provides an overview of the nine basic steps.

## 1 Specify the set of policy options

Policy officers must specify the set of policy options to solve a problem. One of the alternatives should always be 'maintain current arrangements', providing the base case from which the incremental costs and benefits of each alternative can be determined.

## 2 Decide whose costs and benefits count

For most regulatory proposals, measuring the national costs and benefits is appropriate, rather than any international impacts. That is, the costs and benefits to all people residing in Australia should be counted, as far as practical.

## 3 Catalogue the impacts and select measurement indicators

Policy officers should identify the full range of impacts of the policy proposals. Identifying the costs and benefits of a regulatory change involves comparing outcomes with the proposed change to outcomes without the change. For each option, it is important to identify the incremental costs and benefits relative to the base case of what would happen with current arrangements. Changes that would have occurred anyway should not be attributed to the new policy proposal.

All the effects of a policy proposal that are considered desirable by those affected are benefits, all undesirable effects are costs. CBA requires policy officers to identify explicitly the ways in which the proposal makes individuals better or worse off.

The choice of indicators to measure the impacts depends on data availability and ease of monetisation. For example, a regulatory proposal may reduce risks of a hazard. Its positive impact could be measured in terms of reduced numbers of accidents. The benefit from accidents avoided could be valued in dollars in step 5.

## 4 Predict the impacts over the life of the regulatory proposal

The impacts should be quantified for each time period over the life of the regulatory proposal. The total period needs to be long enough to capture all potential costs and benefits of the proposal. In view of the difficulty of forecasting costs and benefits over long periods, caution should be exercised in adopting an evaluation period longer than, say, 20 years (although some environmental regulation may have a longer time horizon).

Prediction of future impacts is difficult. There will always be some uncertainty surrounding the outcome of a regulatory proposal. Assessment of uncertainties should be a standard component of the evaluation of any major proposal. The expected values and variability of cost and benefit flows should be assessed, and downside risks taken into account.

A CBA should present the best estimates of expected costs and benefits, along with a description of the major uncertainties and how they were taken into account. It should set out how costs and benefits are likely to vary with general economic conditions and other influences. For example, would large relative price changes (such as a rise in energy prices or real wages) significantly change the net benefits from the regulatory proposal? If so, what price path might be expected? In general, the CBA should not just assume that the net benefits for one year will be repeated every year.

Although it is difficult to predict what the effects of a regulatory proposal might be in 10 or 20 years' time – or in some cases, even to attach objective probabilities to various scenarios – decisions require some assumptions to be made. A CBA should make these transparent. When policy officers explicitly consider and justify their assumptions, it improves implementation planning and identifies where more effort should be made to improve forecasts. It is a first step towards dealing with the uncertainties the regulatory proposal may create.

## 5 Monetise (place dollar values on) impacts

The net dollar value of the gains and losses of a regulatory initiative for all people affected measures the efficiency effects of change. How many dollars individuals would, if necessary, pay to obtain (or avoid) a change measures how much it is worth to them. The amount could be positive or negative, depending on whether the change makes them better or worse off. Summing these amounts across all affected people gives the community's total willingness to pay for the change. If the sum is positive, the change increases efficiency. The costs and benefits to all people are added without regard to the individuals to whom they accrue: a one-dollar gain to one person cancels a dollar loss to another.

This 'dollar is a dollar' assumption enables resource allocation to be separated from distribution effects — or efficiency from equity effects. That does not mean distributional considerations are unimportant or should be neglected. It means that they should be brought into account as a separate part of the overall analysis of the policy proposal in question – which may be more important than the resource allocation assessment, but should be distinct from it. Dealing with equity issues is discussed in more detail in section B.3.

Dollar values can be estimated from observed behaviour. Policy officers can measure the value people place on something by observing how much they are willing to pay. Market behaviour often reveals people's valuations, or is at least a guide to them. For example, if a consumer pays $3.50 for a cup of coffee, the value they place on the coffee is at least $3.50 (it may be higher).

That said, quantification can be difficult as some impacts are uncertain, some are difficult to value in dollar terms, and some are both uncertain and difficult to value.

Outputs and inputs are less difficult to value when they are bought and sold in competitive markets, even when markets are distorted by taxes. For example, taxes drive a wedge between the (after-tax) price buyers pay and the (before-tax) price sellers receive. The after-tax price for a given unit gives its value to the buyer. The before-tax price measures the value of that unit to the seller.

But competitive markets in the relevant outputs may not exist. For example, a regulatory proposal may yield non-marketed benefits (such as an increase in safety or a reduction in pollution emissions). Section B.2 examines what to do when costs and benefits are difficult to measure, including how to deal with intangibles. Section B.3 discusses equity considerations.

## 6 Discount future costs and benefits to obtain present values

### *Why discount?*

Most of the costs and benefits of regulatory proposals are spread out over time, and their value depends on when they are received. Market rates of interest are positive, indicating that people value a dollar in the future less than a dollar now. For example, if a person can borrow or lend at 6 per cent interest per year, one dollar now is equivalent to $1.06 received in one year's time. One dollar received in one year's time is worth only 94 cents ($1/1.06) now.

A convenient way to add up costs and benefits that accrue at different times is to calculate their present value, which expresses them as an equivalent amount in today's dollars. The rate that converts future values into present values is known as the discount rate. If the discount rate were constant at $r$ per cent per year, a benefit of $B_t$ dollars received in $t$ years is worth $B_t/(1+r)^t$ now. Box B.2 provides an example of how to calculate net present values. The *Handbook of Cost-Benefit Analysis* provides more guidance.[1]

[1] See *Handbook of Cost-Benefit Analysis*, Commonwealth of Australia 2006, chapter 4, pp. 49–62.

### *Accounting for inflation*

Inflation is one reason a dollar in the future is worth less than a dollar now. A general rise in the price level means a dollar in the future buys fewer goods. Future costs and benefits can be valued in nominal or real dollars. In the nominal (or current) dollars approach, the impact of expected inflation is explicitly reflected in the projections (the cost and benefit streams grow faster when expected inflation increases). The real (or constant price) approach expresses all variables in terms of the price level of a given year, usually the present year.[2]

If costs and benefits are measured in nominal (or current) dollars, policy officers should discount with a nominal discount rate; if costs and benefits are measured in real terms (that is, adjusted for inflation), policy officers should discount with a real discount rate.[3] Both methods should result in the same numerical answer.

### *The discount rate for regulatory interventions*

CBA measures the value people place on various policies, preferably using their willingness to pay as revealed by their market behaviour. Consequently, the preferred approach is to base the discount rate on market-determined interest rates, which indicate the value to the current population of future net benefits. Market interest rates determine the opportunity cost of any capital used by the government's regulatory proposal – what it would have produced in its alternative use.

There is uncertainty about the appropriate discount rate to use for regulatory proposals. It is uncertain what the alternative uses of capital used by a proposal would have been and what the capital would have produced in those uses. The OBPR suggests an annual real discount rate of 7 per cent (using sensitivity analysis at 3 per cent and 11 per cent). The OBPR website will publish any updates to the suggested rate. Section B.4 discusses the assumptions that underlie the choice of this discount rate.

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2 See *Handbook of Cost-Benefit Analysis*, Commonwealth of Australia 2006, pp. 60–61, for guidance on how to convert nominal into real flows.

3 The two are related by the formula $(1+r)(1+p) = (1+i)$ where $p$ is the expected rate of inflation (the percentage increase in the price index over the period), $i$ is the nominal interest rate and $r$ the real interest rate. This gives $r = (i – p)/(1+p)$.

Box B.2 **Calculating net present values**

To determine the net present value (NPV) of an option, the costs and benefits need to be quantified for the expected duration of the proposal.

The net present value is calculated as:

$$NPV = \sum_{t=0}^{T} (B_t - C_t)/(1+r)^t$$

where $B_t$ = the benefit at time t

$C_t$ = the cost at time t

$r$ = the discount rate

$t$ = the year

$T$ = number of years over which the future costs or benefits are expected to occur (the current year being year 0)

Consider an option that will require industry to install new equipment to limit air pollution. The equipment costs $5 million to install, and will operate for the following four years. Ongoing (annual maintenance) costs to business are $1 million a year (in constant prices). The benefits are estimated at $3 million a year (in constant prices). The discount rates are 3 per cent and 5 per cent.

| | Costs | Benefits | Annual net benefit | Net present value | |
|---|---|---|---|---|---|
| | ($C_t$) | ($B_t$) | ($B_t$–$C_t$) | 3% | 5% |
| | $m | $m | $m | $m | $m |
| Year 0 | 5 | | -5 | -5.00 | -5.00 |
| Year 1 | 1 | 3 | 2 | 1.94 | 1.90 |
| Year 2 | 1 | 3 | 2 | 1.89 | 1.81 |
| Year 3 | 1 | 3 | 2 | 1.83 | 1.73 |
| Year 4 | 1 | 3 | 2 | 1.78 | 1.65 |
| **Net present value of proposal** | | | | **2.44** | **2.09** |

As with any uncertain variable, sensitivity analysis should be conducted – see below for more information on sensitivity testing. The net present values should be calculated with the real discount rates of 3, 7 and 11 per cent.[4] If the sign of the net present value changes, the sensitivity analysis reveals that the choice of discount rate is important. More consideration should be given to the choice of an

4 This is consistent with the United States Office of Management and Budget 2003, Perkins 1994, and New South Wales Treasury 1997.

appropriate rate. Section B.4 provides more guidance on choosing the appropriate discount rate.

## 7 Compute the net present value for each policy option

The net present value (NPV) of an option equals the present value of benefits minus the present value of costs:

$$NPV = PV(B) – PV(C)$$

If the NPV is positive, the policy improves efficiency. If the NPV is negative, the policy is inefficient. If all costs and benefits cannot be valued in dollars, the policy officer should outline why the non-monetised costs and benefits are large or small relative to the monetised impacts. Section B.2 discusses this point in more detail.

## 8 Perform sensitivity analysis

There may be considerable uncertainty about predicted impacts and their appropriate monetary valuation. Sensitivity analysis provides information about how changes in different variables will affect the overall costs and benefits of the regulatory proposal. It shows how sensitive predicted net benefits are to different values of uncertain variables and to changes in assumptions. It tests whether the uncertainty over the value of certain variables matters, and identifies critical assumptions.

Sensitivity analysis helps assess uncertainties from the regulatory proposal and determines reasonable expected values for costs and benefits. The process of considering and trying to quantify uncertainties is valuable. It identifies the factors critical for policy success, allowing decision makers to focus more attention on estimating and managing them to reduce uncertainty.

If sensitivity analysis is to be useful to decision makers, it needs to be undertaken systematically and presented clearly. Common approaches to sensitivity analysis include the following.

*Worst/best* case *analysis*: The base case assigns the most plausible values to the variables to produce an estimate of net benefits that is thought to be most representative. The worst, or pessimistic, scenario assigns the least favourable of the plausible range of values to the variables. The best, or optimistic, scenario assigns the most favourable of the plausible range of values to the variables. If the pessimistic scenario gives a net present value below zero, it is necessary to

investigate the critical elements driving the value of the regulatory proposal, using the following two techniques.

- *Partial sensitivity analysis* examines how net benefits change as one variable varies over a plausible range (holding other variables constant). It should be used for the most important or uncertain variables, such as estimates of compliance costs, forecasts of benefits and the discount rate. It may be important to vary the values assigned to 'intangibles', especially when the assumed values are controversial.

  Partial sensitivity analysis clarifies for decision makers how the CBA results are affected by uncertainty about the level or value of a variable. If varying a parameter has large effects on the net benefits from the regulatory proposal, uncertainty about its value becomes important.

- *Monte Carlo sensitivity analysis* creates a distribution of net benefits from drawing key assumptions or parameter values from a probability distribution. See Boardman et al. (2006) for more details.[5]

If the sign of the net benefits does not change after considering the range of scenarios, there can be confidence in the efficiency effects of the proposal.

## 9 Rank the policy options

The policy officer should specify which option is the most efficient. Generally, it will be the one with the largest NPV. Given NPVs are predicted (average) values, the sensitivity analysis might suggest that the alternative with the largest NPV is not necessarily the best alternative under all circumstances. For example, the policy officer might be more confident in recommending the option with a lower expected value of net benefits, but with a smaller chance of imposing a significant net cost on the community (lower 'downside risks').

The recommendation should be clearly presented and the analysis should include the time profiles of costs, benefits and net benefits, their net present value, the discount rate used, information on the sensitivity of estimated impacts to alternative assumptions, a list of assumptions made, and how costs and benefits were estimated.

[5] See chapter 7, pp. 181–4.

## B.2 Dealing with costs and benefits that are difficult to value

When a policy proposal uses and produces goods sold in markets, estimating costs and benefits is in most cases conceptually more straightforward and is covered in a number of existing CBA guides.[6]

It is, however, often difficult to identify and measure the effects of a regulatory proposal, especially when there are policy impacts on goods not traded in markets, such as pollution levels and access to scenic views.

Costs and benefits can be difficult to value in dollars because their magnitude may be unknown or uncertain, or because, even if their impact is known, they are difficult to express in money terms. Examples include environmental, social and cultural considerations, regional impacts, health and safety, publicity and national defence.

Cost and benefits should be identified and described. Agencies should then quantify them as much as possible. When valuations are uncertain, sensitivity analysis should be used to test how varying the value assigned affects the overall viability of the policy proposal. If the impacts cannot be valued, they should still be quantified in non-monetary terms. For example, a regulation to reduce pollution could quantify the expected reduction in emissions. The quantification should aim to identify matters such as the assumptions applied to determine the effects, the impact on the community (such as how many people are affected and how) and the likelihood of the full impact being realised.

The process of trying to describe and measure costs and benefits is valuable in itself. By examining what determines the costs and benefits and how they are likely to vary, policy makers are encouraged to consider different approaches and determine the best way to achieve the intangible objectives. Is the policy the best way of producing them — or could a better outcome be produced by some alternative? Even qualitative descriptions of the pros and cons associated with a contemplated action can be helpful.

A wide range of tools have been developed to estimate the value of costs and benefits when direct market information is not available, including revealed preference techniques and stated preference techniques. See Boardman et al. (2006) for more information.

6 See, for example, *Handbook of Cost-Benefit Analysis*, Commonwealth of Australia 2006, chapter 2, pp. 18–24.

## Revealed preference techniques

Revealed preference techniques infer value from observed behaviour. A non-marketed good's value may be reflected indirectly in markets for related goods.

### *Market analogy method*

The public sector supplies many goods and services that are also provided by the private sector. Governments often provide these services free or at below market prices. It may be possible to estimate the value of a publicly provided service by using data on a similar good that is produced by the private sector and sold in a 'normal' market.

### *Trade-off method*

Trade-offs made in other markets may give information on people's willingness to pay for the non-marketed good. The amount people are willing to pay for increased safety from air bags, smoke detectors or other risk-reducing goods can be used to impute the value of an incremental change in the probability of death, and the value of a statistical life (assuming consumers are fully informed about the avoided risks).[7]

### *Hedonic pricing method*

Some market goods comprise bundles of characteristics, some of which are intangible. For example, attributes of a house may include a scenic view or its environment, which may be noisy or polluted. The value of these intangible characteristics can be imputed from house prices. The difference in price between a house under an aeroplane flight path and a comparable house in a quiet street provides an estimate of how much people are willing to pay to avoid aircraft noise. By trading market goods, like houses, consumers are able to express their values for the intangible goods, and these values can be extracted through the use of statistical techniques (such as regression analysis).

### *Travel cost method*

Market and non-market goods can be complements: purchase of market goods and services may be required to access an intangible good or service. This method has been used to value recreational sites. Visitors from different locations bear different

[7] For a definition of the value of statistical life concept, see Viscusi 2006, p. 7.

travel costs depending on their proximity to the site. The resulting differences in the rates of visits that they induce provide a basis for estimating a demand curve for the site. The situation is complicated, however, by the fact that travel can have value in its own right, and that the same costs might be incurred to access more than one site.

### *Defensive expenditure method*

This method measures the amount people spend to mitigate an unmarketed 'bad', such as pollution. If smog worsens, people may spend more on having their windows cleaned. People might buy double-glazing to reduce traffic noise. The mitigation expenditure provides evidence of how individuals value a reduction in the bad. If the defensive expenditures eliminate the bad, their total value provides an estimate of the costs of the unwanted effect.

Boardman et al (2006) have more detail about how to use each of these techniques, and their shortcomings.[8]

## Stated preference techniques

Stated preference techniques rely on surveys to obtain information on how people value costs and benefits. People are simply asked their willingness to pay. These surveys are called contingent valuation surveys.

A survey may be the only way to collect information on non-use values where an individual places value on a resource or activity, even though they may not directly use it or participate, now or in the future. For example, people might be willing to preserve a wilderness area because they place value on knowing that some natural habitat exists for rare animal species.

Boardman et al. (2006) sets out how to conduct contingent valuation surveys and outlines some problems with the technique.[9]

Choice modelling is another survey method, used when the benefits from a policy proposal have many attributes and the policy options provide different combinations of those attributes. It is examined in *Cost-Benefit Analysis and the Environment: Recent Developments* (OECD 2006).[10]

[8] See chapter 13, pp. 337–68.

[9] See chapter 14, pp. 369–402.

[10] See chapter 9, pp. 125–43.

As a rule, estimates of individuals' valuations of goods and services from observing their behaviour in markets tend to be more credible than those from survey questionnaires. Observing purchasing decisions directly reveals preferences, whereas surveys elicit statements about preferences. Survey respondents may have little incentive to take the question seriously, invest in obtaining the information necessary to answer it accurately, or be truthful. They bear little cost for inaccurate or ill-considered answers and may have an incentive to exaggerate.

## Determining impact valuations from secondary sources

The methods discussed above provide a set of tools for the practical valuation of impacts, but may be difficult to implement. When policy officers do not have the resources or expertise to conduct an original study, they may want to 'plug in' values from previous studies. Frequently used plug-ins include the value of a statistical life or life year, value of travel time savings, the cost of noise pollution and the cost of air pollution.

While information from secondary sources can provide a quick, low-cost approach for obtaining desired monetary values, it should be treated cautiously and not used without a clear justification. Judgement is required to determine whether results from a previous study are appropriate to use in a particular regulatory impact analysis. Estimates gleaned from secondary sources may need to be adjusted, depending on the specifics of the particular application.

The accuracy and quality of the original study should be carefully scrutinised. When studies with technical weaknesses are used, the policy officer should discuss any biases or uncertainties that may arise as a result. Clearly, if a study has major weaknesses, it should not be used. In this area, as in others, the OBPR can provide assistance.

## Dealing with costs and benefits that cannot be valued in dollar terms

Some costs and benefits resist the assignment of dollar values. A CBA should nevertheless include all relevant information that can affect a decision in such cases. It should make explicit allowance for costs and benefits that cannot be valued. Policy officers should report cost and benefit estimates within the following three categories:

- monetised;
- quantified, but not monetised; and
- qualitative, but not quantified or monetised.

The challenge for policy officers is to consider non-monetised impacts adequately, but not to overplay them. For example, if a proposal is advocated despite monetised benefits falling significantly short of monetised costs, the RIS should explain clearly why non-monetised benefits would tip the balance.

CBA can encourage decision makers to reveal the limits they place on non-monetised benefits. For example, the monetised costs of a regulatory proposal may exceed monetised benefits by $22 million, which equates to a net cost of $1 per resident over the life of the proposal. Is the non-monetised benefit valuable enough to outweigh the net monetised costs? It may be considered reasonable to assume that the residents value the proposal's non-monetised benefits at more than $1 each. But if the cost were, say, $100 per head, it may not be plausible to assume such a high willingness to pay for the non-monetised benefits.

If quantification is not possible, agencies should at least describe such intangibles in a qualitative manner and evaluate the strengths and limitations of the relevant arguments for taking these impacts into account.

## Cost-effectiveness analysis

Cost-effectiveness analysis is a widely used alternative to CBA in circumstances where policy officers are unable to monetise the most important policy impact. It compares alternatives on the basis of the ratio of their costs and a single quantified, but not monetised, effectiveness measure, such as lives saved. It may be reasonable to use cost-effectiveness analysis if the effectiveness measure captures most of the policy's benefits.

Cost-utility analysis is a form of cost-effectiveness analysis that employs a more complex effectiveness measure, reflecting both quantity and quality. It is generally used in the area of health care. For example, the benefit measure may be quality-adjusted-life-years (QALYs), which combines the number of additional years of life and the quality of life during those years (usually measured on a scale in which a value of one is assigned to perfect health and zero to death). In cost-utility analysis, the incremental costs of various policies are compared to the health changes measured in QALYs that they produce. A similar cost-effectiveness measure that is also used is disability-adjusted-life-years (DALYs).[11]

11 See Boardman et al. 2006, chapter 17, pp. 474–83.

## B.3 Accounting for equity

CBA aggregates costs and benefits across individuals without regard to the equity of the distribution of those costs and benefits. A CBA implicitly counts a dollar gain to one person as cancelling a dollar loss to another. It assumes a dollar is worth the same to everyone. In other words, CBA is directed at whether the proposal delivers a net gain in dollar value to society as a whole, rather than who receives the benefits or who pays the costs. The 'dollar is a dollar' assumption separates a policy's efficiency or resource allocation effects from its equity or distributional effects. This separation is useful, as there is no consensus about the weight to be attached to equity effects. Ultimately, it is up to decision makers to decide the trade-off between equity and efficiency. A CBA can only help to inform the decision.

CBA provides a summary of the efficiency effects of a policy. A policy can be said to improve efficiency if its net present value is positive. While efficiency is important and should be given due weight, it is only one consideration.

The way in which costs and benefits are distributed among various groups, and over time, can also be important to decision makers. While CBA cannot resolve equity issues, it can draw attention to them by quantifying the impacts of proposed policies on different groups. If the information is available, a CBA can identify potential winners and losers and the magnitude of their gains and losses. It is then up to decision makers to decide whether distributional impacts or equity issues are important and need addressing.

A CBA clarifies the trade-offs when comparing alternative policy proposals, such as how much income may need to be sacrificed to achieve other objectives. For example, the decision maker may decide to reject an option with the largest NPV if it has significant adverse equity impacts. The reasons should be made explicit.

## B.4 Determining the social discount rate

When a regulatory proposal imposes current costs on firms and individuals, it increases the demand for capital. For example, firms may need to borrow, or forgo other investment, to cover increased compliance costs. Any capital required by a regulatory proposal must be sourced from displaced investment, newly stimulated savings (that is, decreased consumption) and extra foreign capital inflow. For the regulatory proposal to increase efficiency, its benefits must exceed those to be had from the alternative uses of the capital.

## The weighted average social discount rate

The appropriate discount rate to use in CBA should reflect the social opportunity cost of the capital needs of a regulatory measure. It is the weighted average of the return on different sources of capital. The weights are the proportion of funds drawn from each source.

What is the opportunity cost of the different sources? For displaced investment, it is generally its before-tax marginal return. When consumption is decreased, it is generally the after-tax return on savings. When foreign capital inflow is increased, it is the marginal cost to the national economy. The social discount rate is the weighted average of the rates attaching to each of these major sources.

The returns vary across the different sources because of taxes and market imperfections. For example, income taxes drive a wedge between the before-tax or investment interest rate (the marginal return to investment in capital) and the after-tax or consumption interest rate (the return consumers receive on their savings). The wedge can be quite substantial.

The appropriate social discount rate thus depends on:

- the weighting of each source of capital; and
- what the rates of return would have been for the displaced uses of the capital.

Knowledge about these is generally sketchy. Nevertheless, to use any particular social discount rate is to implicitly make some assumption about these variables, and it is better to make the assumptions explicit. As set out in box B.3, estimates of the real before-tax market return on investment in Australia are at least 8 per cent, the real after-tax return to consumers at least 6 per cent, and the marginal cost of foreign funds at least 5 per cent. Using these bottom-of-the-range numbers, plausible weights on the sources of capital give a weighted average discount rate of between 6.5 and 7.5 per cent. If higher returns are used, the weighted average discount rate would be higher. As a result, the OBPR suggests using an annual real market weighted average discount rate of 7 per cent, and use sensitivity analysis at 3 per cent and 11 per cent.

The OBPR is examining estimates of the underlying parameters and will update the suggested rate as better information becomes available. However, plausible variations in the assumed parameters would be unlikely to change the weighted average rate significantly.

Box B.3 **Weights and real returns for the social discount rate**

Calculating the social discount rate is a complex task. It is uncertain what weights to put on the sources of capital, much less their sub-components. The real social yields of the sources are also uncertain.

The appropriate before-tax rate of return for displaced investment should be the economy-wide market return — the overall yield on private investment in Australia. The consensus is that the real before-tax return on investment is around 8 to 10 per cent. For example, Partnerships Victoria (2003) found the broad market return to be 9 per cent, reflecting a 6 per cent risk premium over the riskless return, and recommended an 8 per cent discount rate for government projects of medium risk. Lally (2000) found the consensus real cost of capital for Australia to be 10 per cent real. Earlier estimates ranged from 10 per cent nominal to 10 to 11 per cent real.[12]

The after-tax market return would be 2 to 3 percentage points lower – between 5 and 8 per cent real. Taxes on the risky component of returns have no effect on individuals, who simply gross up their investments in risky assets to offset the effects of the tax. Portfolio adjustments mean the tax system only taxes the riskless part of the return. The after-tax risk premium is the same as the before-tax risk premium.[13] Complicating matters is that many consumers borrow, and borrowing to finance consumption or owner-occupied housing is not tax deductible in Australia. Their marginal interest rate may be higher than the after-tax market rate.

Makin (2006) estimates the real private cost of foreign funds to be 4.6 per cent, with the net pre-tax return around 9 per cent.[14] The marginal cost of foreign funds is likely to be higher than the average cost when extra borrowing by Australians bids up the price that foreign lenders charge (that is, if the supply curve of foreign funds is upwards sloping).

The consensus is that savings do not respond much to changes in interest rates, therefore most capital used by regulation would come from displacing domestic investment and increased foreign finance. Further, the supply of foreign capital to Australia is considered quite responsive to changes in Australian interest rates.

## Accounting for uncertainty

There will generally be some uncertainty about the cost and benefit flows of any regulatory proposal, and the degree of uncertainty will differ across proposals. Such uncertainty affects how the flows are valued by the individuals involved. Again, the appropriate approach is to use the market price of risk to determine the value

12 See Partnerships Victoria 2003, pp. 17–18, Lally 2000, p. 7, Commonwealth Competitive Neutrality Complaints Office 1998, pp. 9–11, and Department of Finance 1991, p. 57.

13 See Kaplow 2006, pp. 55–6.

14 See Makin 2006, pp. 230, 233.

individuals place on risk. A regulatory proposal's net benefits should be discounted by the return on private assets with similar risk characteristics.

The 7 per cent social discount rate reflects the overall average return to private capital in the economy. It is appropriate to use when the regulatory proposal has an average level of risk (that is, the same as the market).

In general, it is reasonable to assume that the net benefits from most efficient regulatory proposals contain average levels of market risk and the relevant discount rate is the weighted average market return (that is, 7 per cent real). However, that is not the case for all regulatory proposals. Proposals that are more sensitive to market returns should have a higher discount rate, while proposals that are less sensitive should have a lower one.

Given the uncertainty surrounding the discount rate, it is useful to use sensitivity testing with a range of rates, using risk premiums above and below the market risk premium. The sensitivity testing rates — 3, 7 and 11 per cent — represent the weighted average riskless, market and high-risk returns. The OBPR website will publish updates to the suggested rates. If the sensitivity analysis reveals that the choice of discount rate changes the sign of the net present value, choice of the discount rate is crucial and consideration should be given to the risk characteristics of the proposal and the appropriate risk premium.

## Accounting for future generations

Using the weighted average social discount rate to discount future costs and benefits determines the efficiency effects of the policy — the current generation's aggregate willingness to pay. A policy improves efficiency if its net present value is positive.

An issue arises when regulatory impacts cross generational lines (for example, when costs are borne by today's generation but benefits are shared with or received by future generations). Some argue that a lower discount rate should be used for intergenerational discounting. However, there is no consensus about how to value impacts on future generations.

Rather than use an arbitrarily lower discount rate, the OBPR suggest that the effects on future generations be considered explicitly. One way this could be done is to supplement CBA with a discussion of how future generations could be affected by the regulatory proposal.

## B.5 Common cost-benefit analysis pitfalls

Some common pitfalls that arise, particularly in analysing regulatory proposals, include the following.[15]

### Downplaying or ignoring non-financial social costs and benefits

Regulatory proposals differ considerably in the ease and accuracy with which the prospective costs and benefits can be quantified. Although CBA places emphasis on valuing costs and benefits in monetary terms, it is important that the RIS process is not biased in favour of those proposals with impacts that are relatively easy to value. Care should be taken to ensure that monetised impacts do not overshadow other important factors in decision making.

### Double counting benefits

If the costs and benefits of a regulatory change have been estimated from the impact in a primary market, they should not be counted a second time as a result of consequent changes in secondary markets. For example, if a change to transport regulation resulted in savings in travel time to a particular group of homeowners, it would be inappropriate to add the resulting increase in their house prices to the benefits from the regulatory change (which is merely the capitalised equivalent).

### 'Before/after' rather than 'with/without'

The costs and benefits of a regulatory proposal properly relate to changes compared to what would have happened in the absence of the proposal. That is, it is necessary to compare the world without the change to the world with the change. It is inappropriate to merely calculate incremental costs and benefits compared with the status quo, unless no further changes would have eventuated in the absence of the proposal.

### Using the riskless rate of interest to discount net benefits that contain market risk

The riskless rate of interest should only be used to discount net benefits that are uncorrelated with market returns or that have been converted to certainty

15 *Handbook of Cost-Benefit Analysis*, Commonwealth of Australia (2006) lists avoidable pitfalls in CBA in appendix 1, pp. 118–19. This section draws on that discussion.

equivalents. The certainty equivalent of a risky payment is the smallest certain payment the individual would accept in exchange. When a risky payment increases overall consumption risk for a risk-averse individual, its certainty equivalent is less than the expected value of the payment. It would overstate the net present value of a proposal to discount expected values involving market risk using a riskless rate.

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# C Risk analysis of a hazard

Government policies designed to address market failures rarely deal with certainties. Many of the problems that give rise to regulation involve the risk of hazardous events occurring. Regulation aims to reduce the likelihood or frequency of the hazard occurring, or to minimise the consequences if it does occur. Regulation to address hazard risk can seek to:

- reduce the incidence and severity of workplace accidents;
- prevent terrorist attacks;
- minimise the occurrence of health hazards by enforcing food standards;
- improve motor vehicle safety standard designs to reduce the likelihood of car accidents;
- improve minimum product safety standards; or
- prevent the failure of financial institutions by mandating prudential standards.

Risk analysis in a Regulation Impact Statement (RIS) outlines the likelihood of the predicted outcomes of policy alternatives in situations of uncertainty.

Risk analysis is part of the Government's best practice regulation requirements. In 2002 the Organisation for Economic Cooperation and Development (OECD) noted:

> 'Quantitative risk assessment improves the capacity of a government to focus on the most important risks and reduce them at the lowest cost, while identifying those risks that fall below a threshold justifying government action.'[1]

This appendix introduces the concepts of risk and uncertainty, and works through how the risk analysis of a hazard should be incorporated into a RIS.

## C.1 Risk and uncertainty

In discussing risk analysis, a distinction is sometimes made between the terms 'risk' and 'uncertainty'. Risk usually refers to situations in which the probability of a hazardous event occurring is reasonably well known. For full risk analysis to be

[1] OECD 2002, *Regulatory Policies in OECD Countries — From Intervention to Regulatory Governance*, p. 130.

possible, a specific probability distribution can be attached to the mean, or average, outcome in a particular situation. Uncertainty traditionally refers to situations in which the measurable probability of a hazardous event occurring cannot be reasonably estimated. The distinction is often difficult to draw. Probabilities may be assigned to most events, but are seldom known with complete certainty.

Box C.1 **Specifying regulatory risks**

In some situations, the probability of a future outcome can be specified with 100 per cent accuracy. An example of this would be a person flipping a coin — prior to each coin flip, the probability of each outcome can be accurately specified:

| Outcome | Probability |
|---|---|
| Head | 0.50 |
| Tail | 0.50 |

However, predicting real-world outcomes is not like flipping a coin. Real-world outcomes depend on many variables, often more than can even be specified, let alone calculated. This makes predicting real-world outcomes extremely difficult.

Take, for example, a government proposal to upgrade a section of road that is subject to frequent vehicle accidents. The costs and benefits of such a proposal will depend largely on predictions about the number of future crashes on the road. However, road surface quality is only one variable that contributes to vehicle accidents. Environmental conditions (weather, time of day), vehicle conditions, level of driver education and a range of other factors will also contribute to future vehicle accidents.

The purpose of risk analysis is not to provide a conclusive statistical estimation of probabilities. Instead, risk analysis within a RIS highlights issues for which there is less than perfect information about the future. Thus, in practice, the difference between risk and uncertainty is a small one, and not a significant issue when undertaking regulatory impact analysis. This appendix uses the terms ‘risk’ and ‘uncertainty’ interchangeably.

The OBPR considers *risk analysis* to involve an evidence-based approach to incorporating uncertainty about the future into policy advice and recommendations. There are a number of ways in which uncertainty about the future can be accounted for in a RIS, depending on where the uncertainty lies.

## C.2 Accounting for uncertainty in a Regulation Impact Statement

Risk analysis is a feature of the Government's best practice regulation requirements, and must be incorporated into RISs. The goal of risk analysis is to provide a transparent assessment of any uncertainties, so that decision makers are fully informed about the likely outcomes of any policy decision.

Part 6 discussed the RIS process and the seven steps required to complete a RIS:

1. Problem definition
2. Objectives of government action
3. Options to achieve objectives
4. Impact analysis – costs, benefits and risk
5. Consultation
6. Conclusion and recommendation
7. Implementation and review

It is important to note that when preparing a RIS, risk analysis is not a distinct 'step' but an issue to be considered throughout the RIS. How would an analyst conduct a risk assessment of a hazard?

### 1. Problem

The 'problem' section of the RIS outlines the fundamental issues that government intervention is proposed to address. A key component of this is forecasting the potential future outcome under a 'do nothing' scenario (that is, in the absence of government intervention).

Risk assessment involves identifying and calculating:

- the adverse outcome that may occur in the absence of government intervention;
- the probability that the outcome will occur;
- how widespread the outcome is likely to be;
- who is likely to be affected by the adverse outcome; and
- what harm or injury is likely to occur.

Risk comes in a variety of forms, and the type of risk involved will affect any forecast techniques used. 'Actuarial risks' can usually be estimated from historical

data, and arise when an event occurs in large numbers. For example, the likelihood of a traffic accident at a particular location can often be forecast from historical crash data. 'Latent risks', where there is a long time delay between an adverse event and the negative consequence, are more difficult to forecast, and analysis might be based on scientific research of the risk. However, the level of uncertainty surrounding any forecast should be made transparent in the problem section of the RIS.

The problem section should distinguish between real (or actual) risks and perceived risks. Governments frequently implement regulation in response to public calls for increased protection, particularly following significant adverse events. Public perception of risk is often exaggerated and based on unfamiliar or 'sinister' risks (such as the possibility of becoming sick from drinking recycled water), but frequently underestimates more common and much more likely risks (such as the likelihood of being involved in a motor vehicle accident). A RIS should always present an evidence-based assessment of risk.

It is important to note that the problem section will never provide 'conclusive scientific evidence' of the risk faced by society, but rather, an estimate of future uncertainties. Where risk assessment is not able to be undertaken in a RIS, sensitivity analysis can be used to convey uncertainty to decision makers.

## 2. Objectives

The *Objectives* section of a RIS should clearly outline the aims of government intervention. In an uncertain situation, government objectives might include:

- reducing the probability of an adverse event occurring, or
- reducing the potential cost of an adverse event if one does occur.

Government-legislated principles frequently call on departments and agencies to 'reduce overall risk' or 'prevent unreasonable risk'. However, achieving any level of risk reduction entails costs, and in reality individuals make decisions about the level of risk (versus the cost) they are prepared to accept every day. The achievement of zero risk is neither an appropriate, nor technically feasible, goal of government intervention.

The aim of a RIS is to identify 'how much' risk is acceptable to society, and the cost that society is prepared to pay to achieve that. In the end, transparency and consultation are the best way of identifying this trade-off.

## 3. Options

As discussed in chapter 3, the RIS should explore a number of feasible regulatory and non-regulatory options. Different options may affect the probability of an adverse event or reduce the consequences of an adverse event, in different ways.

Government intervention may address risk in a number of ways:

- risk avoidance — prohibit behaviour that gives rise to risks;
- risk transfer — causing another party to bear the consequences of risk;
- risk retention — ensuring parties that face a risk bear the consequences of adverse events; or
- risk reduction — activities to reduce the probability or consequence of risk events.

Options available to departments and agencies to handle risk include compulsory insurance schemes, licensing requirements, enforcement of codes and standards, self-insurance and industry-insurance schemes, proscription of particular activities or outright prohibition. Regulatory intervention should be the *minimum effective regulation* to achieve the Government's objectives.

## 4. Impact analysis

The *Impact analysis* section of a RIS outlines the costs and benefits of each option. If the probability of an adverse outcome is known, and the change in probability can be calculated (for each option), this section can show the expected net benefit (or cost) for each option.

Essentially, step 4 of the RIS follows the same risk assessment process as step 1 (definition of the problem), but is conducted separately for each identified option. If the probability of an adverse outcome is not known, sensitivity analysis can be used to present the level of uncertainty to decision makers for each option.

## 5. Consultation

Consultation may result in better information about the probabilities or consequences of particular risks. Key experts or interest groups should be contacted during the consultation period to seek as much feedback as possible about the probability of an adverse event, or the consequence of an adverse event, for each of the options analysed.

## 6. Conclusion and recommended option

The RIS should recommend the policy option with the highest expected net benefit, after accounting for risk in the analysis. This provides decision makers with a more complete analysis than if the results are presented as being accurate and certain.

## 7. Implementation and review

The RIS should outline how new scientific evidence of risk will be incorporated into the policy. As outlined in chapter 3, the recommended policy should be implemented with the minimum effective regulation required to meet the Government's objectives.

As part of the Australian Government's best practice regulation requirements, departments and agencies will be required to undertake targeted reviews of regulations every five years. It is important that the effectiveness of any selected response be monitored and reviewed. The review process should examine:

- whether the risk was adequately identified and accurately estimated in the initial assessment;
- what impact government intervention has had on the risk (whether the risk has been reduced, increased or otherwise changed);
- whether the selected government intervention is still appropriate, and
- whether or not (if at all) the intervention should remain to reach an acceptable level of risk reduction (noting that achievement of zero risk is neither achievable nor desirable).

## Further reading

Boardman, E.A., Greenberg, D.H., Vining, A.R., and Weimer, D.L. 2006, 'Dealing with Uncertainty' in *Cost-Benefit Analysis – Concepts and Practice*, 3rd edn, Pearson Prentice Hall, New Jersey, pp. 165-199.

Commonwealth of Australia 2006, *Handbook of Cost Benefit Analysis*, January.

# D Business Cost Calculator

This appendix provides additional details about the use of the Business Cost Calculator (BCC).

The BCC is an IT-based tool designed to assist policy officers estimate the business compliance costs of various policy options. The BCC can be downloaded from the OBPR website (www.obpr.gov.au). If you have any queries about how to apply the BCC to your regulatory proposal, contact the OBPR.

The Australian Government requirement that the BCC (or an approved equivalent) be used to consider whether regulatory proposals have compliance costs for business is outlined in part 3. Regulations generally impose a wider range of costs than just compliance costs and affect a wider range of stakeholders than just businesses. The way in which the BCC fits into the *Impact analysis* section of a Regulation Impact Statement (RIS) is discussed in part 6.

## D.1 Scope of the Business Cost Calculator

The BCC has been developed to provide an automated and standard process for quantifying compliance costs of regulation on business. The BCC is derived from the Standard Cost Model[1], designed by the Dutch Government to measure the size of the administrative or 'paperwork' burden on business. The BCC defines compliance costs more broadly than the Standard Cost Model and includes all direct compliance costs, not just paperwork costs. This broad definition provides a greater scope for capturing the compliance costs of regulation.

The BCC identifies eight categories of compliance tasks. The ninth category, 'Other', is used to capture costs not readily classifiable to one of the eight (see table D.1).

[1] For more information see International SCM Network to Reduce Administrative Burdens 2005, *The International SCM Manual: Measuring and Reducing Administrative Burdens for Business*, October.

Table D.1 **Compliance task categories in the Business Cost Calculator**

| *Compliance tasks* | *Examples* |
|---|---|
| **Notification** — businesses incur costs when they are required to report certain events to a regulatory authority, either before or after the event has taken place. | Businesses may be required to notify a public authority before they are permitted to sell food. |
| **Education** — costs are incurred by business in keeping abreast of regulatory requirements. | Businesses may be required to obtain the details of new legislation and communicate the new requirements to staff. |
| **Permission** — costs are incurred in applying for and maintaining permission to conduct an activity. | Businesses may be required to conduct a police check before legally being able to employ staff. |
| **Purchase cost** — in order to comply with regulation, businesses may have to purchase materials or equipment. | Businesses may be required to have a fire extinguisher on-site. |
| **Record keeping** — businesses incur costs when required to keep statutory documents up to date. | Businesses may be required to keep records of accidents that occur at the workplace. |
| **Enforcement** — businesses incur costs when cooperating with audits, inspections and regulatory enforcement activities. | Businesses may have to bear the costs of supervising government inspectors on-site during checks of compliance with non-smoking laws. |
| **Publication and documentation** — costs are incurred when producing documents required for third parties. | Businesses may be required to display warning signs around dangerous equipment, or to display a sign at the entrance to home-based business premises. |
| **Procedural** — some regulations impose non-administrative costs. | Businesses may be required to conduct a fire safety drill several times a year. |
| **Other** — when a compliance cost cannot be categorised into one of the above categories, it can be placed into this category. | |

## D.2 Use of the Business Cost Calculator

As outlined in part 3, all regulatory proposals must undergo a preliminary assessment to establish whether they are likely to involve business compliance costs.

If there are any compliance costs, policy officers will need to assess whether the impact is low (for more information on what is 'low' see section 3.1). If the impact of a regulatory option is low, policy officers do not need to undertake any analysis using the BCC.

If a preliminary assessment shows that the proposal will involve compliance costs and the impact is not low, the BCC (or equivalent) must be used to make a full assessment of those costs. Where policy officers are unsure, they should, contact the OBPR.

## BCC *Quickscan*

The BCC asks for the following information:

- the problem you wish to address;
- the objective of this policy; and
- basic information for each policy option:
  - a description of the policy option; and
  - the number of businesses affected.

The BCC *Quickscan* helps policy officers gain an initial understanding of the tasks a business may need to complete to comply with a proposal, and introduces the cost categories listed in table D.1. For each policy option, the BCC *Quickscan* asks you to identify whether businesses will be required to perform tasks in any of the nine compliance cost categories. You will need to indicate 'yes' or 'no' for each cost category. After this information is entered into the BCC, *Quickscan* will then indicate whether you need to proceed to the BCC *Cost Options* step.

## BCC *Cost Options*

The *Cost Options* step of the BCC requires more details about the compliance tasks associated with the policy options, supporting evidence for this information, and the level of certainty about this information. There may be a number of compliance tasks (with a number of associated compliance activities) for each policy option.

For each compliance task, information is required about:

- the category of the compliance task and related compliance activities;
- whether the task is an internal cost or outsourced cost;
- whether the task is a start-up or ongoing cost;
- the number of businesses that will have to undertake that compliance activity;
- how long the activity will take and how often it will have to be done;
- who will perform the task and the associated labour cost, including on-costs (for tasks carried out internally), or the purchase cost (for tasks that are outsourced or where the task is the purchase of materials or equipment); and
- supporting evidence for this information and the level of certainty.

The BCC provides an executive summary called the BCC report and a number of other reports (by business, or for total businesses) about compliance costs, including:

- compliance costs by cost category;
- compliance costs by task;
- summary report of total compliance costs; and
- summary of supporting evidence.

## Data sources

The information required for input into the BCC can come from a variety of sources. The BCC contains a number of links to help officers search for data, such as the Australian Bureau of Statistics, the Business Licence Information System and WageNet. You can access these links by selecting the 'Help' icon in the BCC and going to the 'Links' page.

Where the detailed information required is not readily available, the organisation responsible for preparing the BCC report should seek to acquire it through consultation or research. Some possible ways of collecting data are:

- seeking compliance information from businesses through a consultation process (better feedback may be obtained if business are given some preliminary estimates to comment on);
- approaching industry associations or peak bodies;
- surveying businesses;
- using Australian Bureau of Statistics data, especially on business populations; and
- holding workshops with participation from relevant businesses.

## Supporting information

The BCC is supported by a wide range of online tools designed to assist policy officers.

There is a range of guidance material to assist you in downloading and using the BCC software, including:

- **Quick-Start Guide** — a two-page document that outlines installation and use of the BCC;

- **User Guide** — a comprehensive guide to help users work through policy options and estimate compliance costs; and
- **Cost category Guide** — provides examples of how to categorise different activities.

Video tutorials provide an interactive and visual tour of how to use the BCC to estimate compliance costs. These tutorials provide a worked example which is also available as a paper-based tutorial.

The OBPR also provides a range of training sessions on the BCC. These sessions include overview sessions as well as one-on-one training.

For further information and assistance on the BCC, contact the OBPR at helpdesk@obpr.gov.au.

# E Cost recovery and the Regulation Impact Statement process

## E.1 Government's cost recovery policy

In December 2002, following an inquiry by the Productivity Commission (2001),[1] the Australian Government adopted a formal cost recovery policy to improve the consistency, transparency and accountability of its cost recovery arrangements and promote the efficient allocation of resources.

For the purposes of this policy, *cost recovery* broadly encompasses fees and charges related to the provision of government goods and services (including regulation) to the private and other non-government sectors of the economy.

All agencies with significant cost recovery arrangements will need to prepare a Cost Recovery Impact Statement (CRIS). While all cost recovery arrangements must comply with the cost recovery policy, only those cost recovery proposals with a major budget impact or cost recovery reviews initiated by the Minister for Finance and Administration are required to present a Cost Recovery Impact Statement (CRIS) to Expenditure Review Committee (ERC). All CRISs are required to be published online. Portfolio Ministers are ultimately responsible for ensuring agencies' implementation and compliance with the cost recovery policy and considering other CRISs.

In essence, a CRIS transparently documents how an agency's fees and charges comply with the cost recovery policy. The CRIS should:

- demonstrate that charges reflect the costs of providing the good or service;
- identify the beneficiaries of the good or service, or the individuals or group that have created the need for regulation; and
- identify whether a fee-for-service or a levy is the most appropriate means to impose the charge.

[1] Productivity Commission 2001, *Cost Recovery by Government Agencies*, Report No. 15, 16 August, AusInfo Canberra.

Please refer to the Department of Finance and Administration (DoFA), *Australian Government Cost Recovery Guidelines* (July 2005) for more information on the cost recovery policy and the CRIS.

## E.2 Cost recovery statements and the Regulation Impact Statement process

If cost recovery is part of a proposed regulatory change that triggers the Regulation Impact Statement (RIS) requirements — that is, the regulatory change will have a significant impact on business and individuals — cost recovery must be examined in a separate CRIS document. In this case, the proposal comes under the purview of DoFA, not the OBPR. Agencies seeking to confirm when a RIS or a CRIS is required may consult the OBPR or DoFA.

Where a regulatory proposal that includes a cost recovery element triggers the RIS requirements:

- the OBPR will advise DoFA of the cost recovery proposal;
- the OBPR will advise the department/agency about the Government's cost recovery requirements; and
- DoFA will provide assistance to the department/agency in relation to preparing a separate CRIS.