

# Regulatory impact assessment: key to good governance

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*Determining whether regulation meets the dual goals of 'effectiveness' and 'efficiency' requires a structured cost-benefit approach to policy development. The relevant problem to be addressed and subsequent policy objective should be identified as the first step in the policy development process, followed by consideration of a range of options (including no action) for achieving the objective. The benefits of any regulation to the community should outweigh the costs.*

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Regulatory impact assessment or RIA is a tool for providing systematic assessment of the positive and negative impacts of proposed and existing regulations with the aim of improving the quality of a regulatory policy. It not only encourages regulators and policy-makers to think in a structured way before they act but also increases accountability of regulatory actions.

RIA can be used to analyse existing as well as new regulations. In an ex ante analysis, RIA is conducted prior to the adoption of a proposed regulation. The collection and analysis of costs and benefits is, thus, done before administering a regulation. It involves a specification of the rationale for a proposed regulation, the likely direct and indirect costs, a qualitative description of the benefits, an assessment of other alternatives, and an explanation as to why the other alternatives were not selected.

On the other hand, an ex post analysis is conducted on a regulation that is already in existence. While it attempts to measure the real impact of a regulation, it offers little information on the situation that might prevail in absence of the regulation. Nevertheless, it helps to set examples for future regulations and also provides an opportunity to take corrective action against previous inaccuracies or mistakes.

## Approaches to Regulatory impact assessment

The basic feature of RIA is a systematic examination of the advantages and disadvantages of the possible methods of achieving an identified objective. A number of different approaches are

available for such systematic analysis. These are discussed below.

**Risk analysis** Risk analysis involves a quantitative assessment of the magnitude of total risks being reduced as a result of a proposed regulation. This approach focuses only on the aspect of risk reduction and there is no corresponding assessment of the costs incurred to achieve such reduction or of the societal interests. Both qualitative and quantitative data is used for undertaking analysis of whether the risk is likely to increase or decrease over a specified period of time. An example of the use of risk analysis can be seen in a recent study in the United States, which found that if the existing regulations were retargeted at those risks where lives could be saved at the lowest cost, some 60 000 more deaths could be avoided each year without increasing regulatory costs.

**Cost-benefit analysis** Cost-benefit analysis involves the identification and calculation of all costs and benefits associated with a regulation. Under this approach, the total benefits associated with the regulation are compared with the total costs and if the balance is favourable, the regulation is considered feasible. The rationale for this approach is that resources are limited and should therefore be allocated in a manner, which maximizes the net benefit to society. Regulatory decisions have favourable as well as unfavourable impacts and this approach ensures that the decision-making process takes into consideration the societal interests as a whole.

<sup>1</sup> An Office of Regulation Review report, *A Guide to Regulation*, (2nd edn) December 1998, was released on 29 January 1999. It has been prepared for use by policy and regulatory personnel in

all the Australian government departments, agencies, statutory authorities, and boards. It can be accessed at <<http://www.pc.gov.au/orr/reports/guide/reguide2/>>.

There are several examples of the use of cost-benefit analysis. In 1985, the EPA (Environmental Protection Agency) in the United States conducted RIA of its proposed rule to reduce lead in gasoline. The analysis focused on the assessment of costs and benefits of reducing lead in gasoline. Lead, which has been historically added to gasoline to boost octane was proved to adversely affect children's health and learning capability and also cause blood-related problems in adults. From RIA, the EPA concluded that the primary costs would result from the phasing out of lead in gasoline at refineries. Further, it estimated that these costs would be 3.6 billion dollars between 1985 and 1992. The anticipated health benefits and better fuel economy were estimated to be 50 billion dollars over the same period.

*Cost-effectiveness analysis* Cost-effectiveness analysis provides an index of the relative costs of various options for promoting a particular objective in society. This approach helps to select policies that minimize the cost of eliminating a given risk. The cost-effectiveness measures provide a useful guide to the relative performance of different policies.

An example of the use of this tool can be seen in the case of El Salvador. Cost-effectiveness analysis has been used in El Salvador to compare on one hand, educational reform and teacher retraining while on the other, educational television as a means of providing education for a significant proportion of the population of primary-school age. It was estimated that the average cost per student for using television to teach math was 22 dollars and the average math test gain score was 3.7 points, giving a cost-effectiveness ratio of 5.9 (= 22/3.7).

*A combined approach* A combination of the above-mentioned approaches can also be adopted. For example, a study undertaken in western Australia to estimate the economic impacts of reforms of electricity industry used the cost benefits as well as the risk-analysis approach. The resulting analysis indicated that the reforms were likely to produce significant benefits despite the additional administration and implementation costs. Further, as per this analysis, the average retail prices to customers would fall by about 5%–8.5%.

Approaches such as cost assessment and benefit assessment can also be used for conducting RIA. However, these are partial approaches

that focus on a single aspect and do not provide comprehensive guidance for decision-making.

## International experience

International experience reveals that RIA is currently being used significantly in a number of countries world over. In several of these countries, RIA was developed as a response to the growing volume and complexity of government regulations in the 1980s. It had also become clear that the 'invisible' regulatory compliance costs for businesses and citizens, for example, the costs of administrative formalities, were much higher than the 'visible' costs on government budgets. These costs could have severe negative effects on businesses, consumers, and the economic performance, in general. Thus, RIA programmes were designed and used to systematically identify these costs and benefits and the alternative ways to achieve government goals more cost-effectively.

RIA has been adopted in most OECD (Organisation for Economic Co-operation and Development) countries—at the beginning of 2001, 20 out of the 28 member countries were applying RIA, although the extent of use varied. On the other hand, despite considerable interest in measuring the effectiveness of a development policy and in the design and implementation of regulation measures, it appears that the potential of RIA has neither been explored nor analysed in the developing countries and in their organizations involved in the design and formulation of a development policy. In the developing countries, in most cases RIA has been undertaken in middle-income countries, especially South Korea and Mexico. Although there has been some interest in the concept among the Asia-Pacific Economic Cooperation members and in certain parts of central and eastern Europe, it appears that there has been little progress in adopting RIA in these regions. In Africa, the Middle East, and much of Asia, it seems that RIA has not been seriously considered within the government or perhaps has not been known at all, in spite of a recognized need to build regulatory capacity in the developing countries.

In most countries where RIA has been adopted, it has been defined as a two-step process. The first step involves an identification of the need for regulation. The second step is the

quantification of the potential benefits and costs of different methods of regulation. While these have been the common steps, an interesting feature is that every country does not have the same approach to RIA. The approach in each country has been seen to vary in accordance with the underlying institutions and guiding forces in that country.

RIA is usually performed by the regulator and is also referred to as business impact assessment, regulatory impact statement, etc. It has been carried out for a multitude of areas and sectors ranging from health and safety, environment, agriculture, transportation, fisheries, etc., though its application in the infrastructure sector has been limited till now. It is mostly in the OECD countries that such assessments have been undertaken. However, there is now a growing recognition that such assessments are needed in infrastructure sectors also, especially with the onset of regulatory reforms in these sectors in the past few years.

In the United Kingdom, there are three milestones in the development of RIA: initial, partial, and full. An initial RIA establishes the purpose and intended effect of a regulation. It is a rough and ready working assessment of policy options, using the already available information. A partial RIA deliberates upon various policy options and seeks the opinion of key professionals and stakeholders such as economists, small business services, etc. It also involves a risk-assessment analysis, cost-benefit analysis, and analysis of the compliance issues related to each option. The results of these consultations form a part of the full RIA. The full RIA also includes recommendations for actions, future monitoring, and evaluation.

In Canada, RIA has been an important component of the Federal Regulatory Reform process. Canada's RIA programme serves three major purposes: provision of a framework for the consideration and management of regulatory initiatives in the federal department agencies, collection of basic information to reach decisions, and public provision of information. RIAs are used as a means by which departments demonstrate that the proposed regulation meets the requirements of Canada's regulatory policy.

RIA programme in Canada has also evolved over the years with the use of 'how-to' guides,

training courses, and tools such as business impact tests. The strength of Canada's RIA programme lies in its flexibility. Different departments and agencies adopt different approaches and methods to assess regulatory impacts. Adequate attention is also given to stakeholder involvement, requirements of the cost-benefit analysis, indirect effects, and small businesses.

Successful RIA programmes have been undertaken in Canada in almost all departments and specifically in the fields of telecom, environment, health, finance, public-private partnerships, and natural resources. In many cases, the proposed regulation was revised on the basis of impact analysis and then accepted by the concerned parties. An OECD report on regulatory reforms in the telecom sector of Canada examined Canada's regulatory reforms effort and its impact on the performance of telecommunications markets. It concludes that the development of competition in the telecommunications service sector has shown good progress but as is the case for other OECD countries, it is still insufficient for local telephone services and local access and in the short-distance leased-line market. But many of the contentious regulatory problems that have marred performance in other OECD countries have largely been resolved in context of the Canadian telecommunications. However, there is scope for continuing reforms of the Canadian telecommunications policy framework and regulatory structures and processes. This ex post assessment however did not attempt a cost-benefit analysis of the reforms undertaken in the telecom sector in Canada.

The OECD (1997) has noted that RIA contributes to a 'cultural shift' whereby the regulators become more aware of the costs of action and are more forthcoming to adapt decisions to reduce costs. It states '...RIA attempts to widen and clarify the relevant factors of decision-making. It implicitly broadens the mission of regulators from highly focused problem solving to balanced decisions that trade-off problems against wider economic and distributional goals. Far from being the technocratic tool that can be simply 'added on' to the decision-making system by policy directives, it is a method of transforming the view of what is appropriate action, indeed, what is a proper role of the state'.

There is nearly universal agreement that RIA, when executed effectively, improves the effectiveness of regulatory decisions. The effectiveness of a RIA programme is the increase in a society's net benefits arising from regulatory improvements attributed to RIA. There are many examples on that: in the United Kingdom, the costs to business of new food storage standards were reduced by 41 million pounds annually after a compliance cost assessment showed that a slight increase in the allowable storage temperatures would not compromise food safety.

Similarly, in Victoria (Australia), RIA showed that a proposal to prevent large trucks from using a major bridge would add more than 20 million dollars to transport costs without improving the net safety outcomes and, hence, the proposal was abandoned.

The US regulatory process also uses RIA to add structure, rigor, and transparency to the regulatory review. The US government notes the OECD's (1997) assessment that proper execution of RIAs can be effective in helping in the production of the most effective least-cost regulatory instruments. While RIAs are necessarily complex and can be costly, taken by themselves, the US has found them to be important tools in the development of a more balanced regulatory approach. The cost-benefit analyses, conducted by the USEPA (United States Environmental Protection Agency) in 1981-86 were influential in the revisions to three regulations. The estimated net benefits to society were increased by over 10 billion dollars as a result of these revisions. It would be important to note that because only 8.1 million dollars were spent to conduct these analyses, the USEPA's 'return on investment' was over 1000 to 1.

### **Importance of Regulatory impact assessment**

The four main objectives of RIA that emerge from an examination of international experiences are discussed in the following paragraphs. The importance of RIA is evident from these objectives.

*Facilitate understanding of impacts of regulatory actions* One of RIA's goals is to promote an understanding of the regulatory activities, ensuring that the benefits of a regulatory action justify the costs and that the option chosen maximizes benefits and

minimizes costs. It can be said that the most important use of RIA lies in helping decision-makers to question more thoroughly their reasons for regulating, to consider other alternatives, to evaluate the impacts, and to become more capable for making better decisions and regulations.

*Integration of multiple policy objectives* There has to be an awareness that any policy or regulatory decision has wide economic implications and effects, such as those on economic efficiency, poverty alleviation, trade, environment, etc. RIA helps in the integration of these multiple policies that affect each of the above-mentioned issues.

*Improve transparency and consultation* RIA improves the transparency of decisions and enhances consultation and participation of the affected groups, thereby adding an empirical dimension to consensus and political/regulatory decision-making methods. Making stakeholder consultations a requirement of the RIA programmes and encouraging these early in the process are important features of the programme. Stakeholder consultations help to ensure that the 'best' regulations or alternatives are selected, and that all regulatory impacts are identified and assessed appropriately. Stakeholder consultations might also lead to deletion of outdated and irrelevant regulations that are not being enforced.

*Improve accountability of governments and regulators* RIA increases the involvement and accountability of decision-makers at all levels. Not only does it bring their actions under public scrutiny and highlights how their decisions benefit the society as a whole but also mandates greater information sharing.

### **Issues and constraints**

An assessment of the results achieved through investments in RIA presents a mixed picture. This has been brought out by Jacobs (1997) in his paper *An overview of regulatory impact analysis in OECD countries*. On one hand, there is consensus that RIA, if undertaken properly, improves the cost-effectiveness of regulatory decisions. As mentioned earlier, an evaluation of 15 RIAs in 1987 by the USEPA found that while it had cost 10 million dollars to conduct these RIAs, it resulted in revisions of regulations with estimated net benefits of about 10 billion dollars, implying a

benefit cost ratio of about 1000 to 1. On the other hand, there is evidence of non-compliance and quality problems in RIA. A survey of benefit cost analysis in the US revealed that half of the adopted regulations did not pass a benefit cost test even after 15 years of investment in the benefit cost programme.

The common problems associated with RIA are listed below.

- Non-availability of data
- Complex and costly analytical methods
- Quantification of intangible benefits
- Determination of appropriate assumptions about risk levels
- Difficulty in assessment of indirect effects
- Resistance from interest groups and regulators towards the new arrangements that may result from RIA
- Inability of regulators to undertake RIA and comply with its requirements due to lack of skills or resources
- Lack of quality control leading to reduction in benefits of RIA
- Political and bureaucratic interference
- RIAs are often undertaken at later stages of the decision-making process.

Another constraint that may impact the quality of the analysis conducted is the fact that RIA tends to be based on theoretical considerations, with limited empirical inputs due to the reasons mentioned above. It is thus imperative that a RIA programme is carefully designed, operated, and monitored.

## Conclusion

Quality control provided by an effective RIA is an important aspect of the decision-making process. Such analysis helps to ensure that all the important factors and impacts are known when decisions are being made. An important advantage of impact assessment is that it focuses on the factors relevant for choosing the best feasible alternative to a policy issue. Impact assessment helps to establish the likely magnitude of the costs and benefits of alternative ways of addressing an issue as well as making clear the areas where quantitative values cannot be calculated. It is in areas

where monetary values cannot be attributed that important judgements have to be made by governments as well as regulators about the relative merits of the alternatives.

It is widely acknowledged that a sound regulation is the key to good governance and greater regulatory effectiveness in turn means a better government. Sound regulation depends on the quality of the decision-making processes and the way policy instruments are chosen. It is thus important that impact assessment be integrated into the decision-making process from the beginning of the formulation of proposals, instead of at later stages in the process simply to comply with the externally imposed requirements. Among other things, integration would help the earlier consideration of a greater variety of solutions, whether regulatory or non-regulatory.

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