



Australian Government

Best Practice Regulation Handbook

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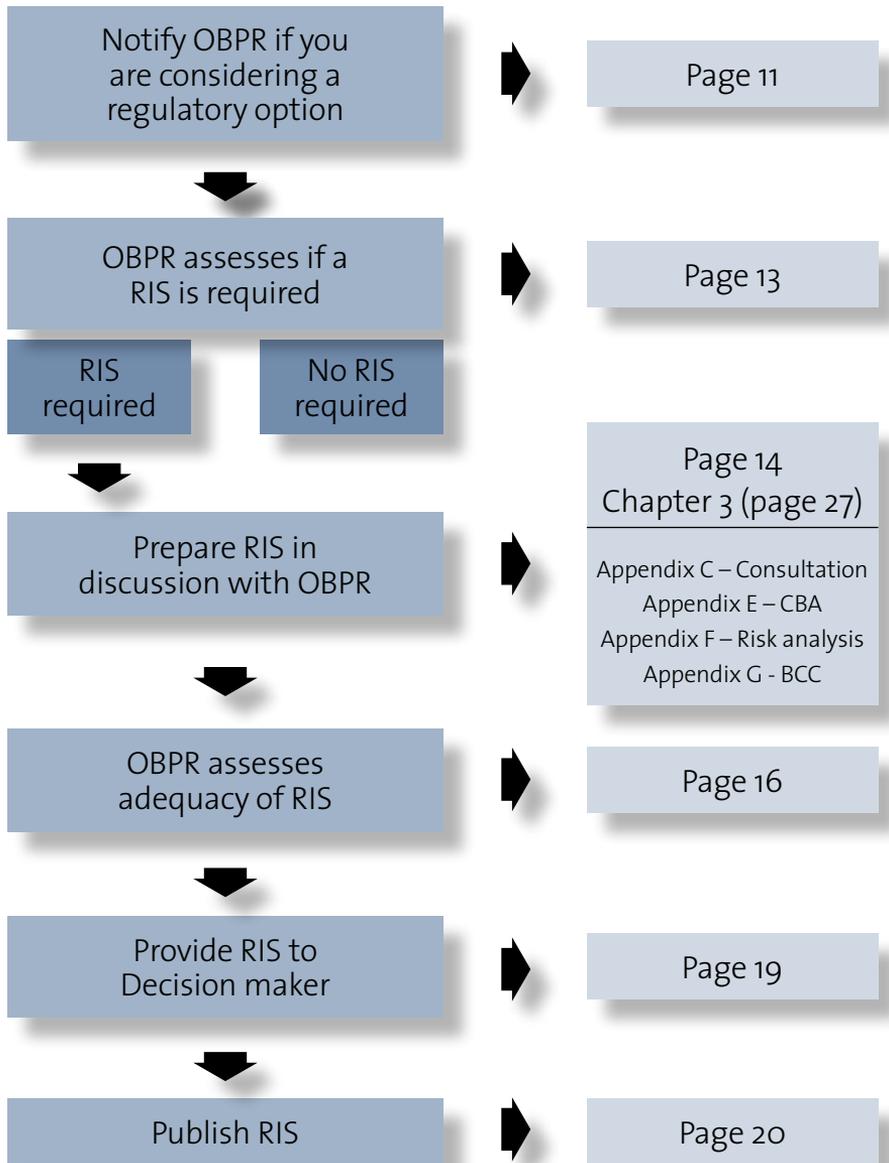
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A QUICK GUIDE TO THE HANDBOOK



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FOREWORD

Well designed regulation has a vital role to play in overcoming some of the problems that lead to inefficient or inequitable market outcomes. However, 'well designed' is an important qualifier. Poorly designed regulation may not achieve its objectives and can impose costs on businesses and the community more broadly.

The Australian Government has reaffirmed its commitment to a rigorous system for assessing the impact of regulatory proposals and alternative options. The government's Regulatory Impact Analysis requirements promote well-designed regulation by:

- requiring a case to be established for acting in response to a perceived policy problem, including addressing whether regulatory action is required and whether the proposed regulation achieves the policy objective in a manner that minimises costs for business and the community
- encouraging transparent, timely and meaningful consultation with affected parties
- assisting decision makers to understand the full range of costs and benefits of their decision, at the time they are making their decision, and
- making the information available to government decision makers available to the public.

This is an internationally recognised framework, and has been strongly commended in a recent review by the Organisation for Economic Cooperation and Development.

In reaffirming a rigorous system, the government has agreed to a number of changes to the Regulation Impact Statement (RIS) requirements aimed at better balancing the rigour and practicality of the RIS process. These changes are reflected in this revised edition of the *Best Practice Regulation Handbook*.

THE HON LINDSAY TANNER MP

Minister for Finance and Deregulation

1. PRODUCTIVITY AND REGULATION

- 1.1 The potential for productivity growth to generate higher incomes for Australians makes it a natural and important consideration for decision makers. Productivity is the only driver of income growth that is unlimited, as opposed to resource exploitation or increases in population and labour force participation, each of which face natural limits. The continuing need to stimulate productivity rightly remains at the forefront of government policy.
- 1.2 Almost all regulations have the potential to impact on productivity, either through the incentives which they provide to businesses to change operating and investment decisions, or more directly through their impacts on compliance costs. It is inconceivable to think of a modern economy functioning without regulation. Regulation is the *lifeblood* of a modern, well-functioning economy. However, poor regulation can cause frustration and unintended consequences, or simply add red tape that adds nothing useful to the economy.

Australia's productivity story

- 1.3 Productivity improvement has been one of the key drivers of enhanced Australian material living standards over the last forty years. The productivity growth surge in the 1990s was driven by microeconomic reforms in the 1980s and 1990s that increased the influence of market forces. Markets assist in enhancing the efficiency of Australian industries by lowering input costs and maximising competitive pressures which, in turn, increase the incentives for firms and industries to be innovative and entrepreneurial.
- 1.4 The Productivity Commission found that observed productivity and price changes in the key infrastructure sectors in the 1990s – to which microeconomic reforms have directly contributed – have increased Australia's annual GDP by 2.5 per cent.
- 1.5 Productivity growth rates have fallen during the first decade of the 21st Century from the previous high levels of the 1990s. Although still subject to debate, this may reflect the short term economic shocks from a severe drought on agriculture, water and the electricity sector, increased investment in mining resulting in a higher use of mining resources with lower yields as well as more systemic factors.
- 1.6 The opportunities and challenges of ongoing globalisation are diverse. There is increasing demand for Australian exports from rapidly developing economies such as China and India, driven by rising incomes and consumer expectations for higher quality goods and services in these countries. This provides opportunities not only for the Australian primary and resources sectors, but also for the services sector (such as education, tourism and financial services).

- 1.7 Competitive pressure from lower labour cost countries has been a feature of the past which has led to the transformation of Australian firms and the economy – and rising incomes and living standards for Australians. This competitive pressure can be expected to continue.
- 1.8 Factors that can improve productivity include technological change (adopting new knowledge), investment in human capital (such as education and training), investment in physical capital (such as transport and communication networks), and high quality regulation that is efficient and effective.
- 1.9 In order to reap the benefits and respond to the challenges of ongoing globalisation, the Australian economy needs to remain as efficient, flexible and responsive as possible. Rather than providing specific industry support, it is more effective to ensure that general microeconomic settings are in place to allow industries with the best prospects to compete so that the most productive industries will be winners.
- 1.10 The best practice regulation process seeks to assist the government in meeting these objectives. It is for this purpose that the best practice regulation-making requirements exist – they are a means to an important end.

Best practice regulation making

- 1.11 While regulations are essential for the proper functioning of society and the economy, 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.
- 1.12 Determining whether regulation meets the dual goals of effectiveness and efficiency requires a structured approach to policy development that systematically evaluates costs and benefits.
- 1.13 The problem to be addressed and the related policy objective should be identified as first steps in the policy development process. A range of options for achieving the objective should be considered (as well as no action or the status quo option); and an analysis of the likely economic, social and environmental consequences.
- 1.14 Effective 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.

- 1.15 The broader concept of transparency in government has become increasingly important for regulatory governance. Transparency can improve accountability as well as address issues concerning regulatory failure, such as regulatory capture, rigidity, market uncertainty and inability to understand policy risk.
- 1.16 The Australian Government's best practice regulation requirements provide a systematic approach to ensure high quality regulation and are consistent with the OECD Guiding Principles for Regulatory Quality and Performance.

OECD Guiding Principles

- 1.17 The Organisation for Economic Co-operation and Development (OECD) contends that a coherent, whole-of-government approach is needed to create a regulatory environment favourable to the creation and growth of businesses, productivity gains, competition, investment and international trade (OECD 2005). The OECD *Guiding Principles for Regulatory Quality and Performance* captures the dynamic, whole-of-government approach to implementing regulatory policy.
1. Adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.
 2. Assess impacts and review regulations systematically to ensure that they meet their intended objectives efficiently and effectively in a changing and complex economic and social environment.
 3. Ensure that regulations, regulatory institutions charged with implementation, and regulatory processes are transparent and non-discriminatory.
 4. Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.
 5. Design economic regulations in all sectors to stimulate competition and efficiency, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.
 6. Eliminate unnecessary regulatory barriers to trade and investment through continued liberalisation and enhance the consideration and better integration of market openness throughout the regulatory process, thus strengthening economic efficiency and competitiveness.
 7. Identify important linkages with other policy objectives and development policies to achieve those objectives in ways that support reform.
- 1.18 These principles have been endorsed by the Australian Government and serve to provide broad guidance on its regulatory governance arrangements. The aim in this Handbook is to implement the principles in a clear, concise and practical way.

2. THE GOVERNMENT'S REGULATORY IMPACT ANALYSIS REQUIREMENTS

- 2.1 Regulatory Impact Analysis (RIA) is the process of examining the likely impacts of a proposed regulation and a range of alternative options which could meet the government's policy objectives.
- 2.2 The Australian Government's RIA requirements are intended to achieve better regulation by supporting:
 - *Sound analysis*. The case for acting in response to a perceived problem, including addressing the fundamental question of whether regulatory action is required, needs to be demonstrated. The analysis should also outline the desired objective of the response, a range of alternative options to achieve the objective, and an assessment of the impact of each option, and should be informed by effective consultation.
 - *Informed decision making*. To help decision makers understand the implications of options for achieving the government's objectives, they should be informed about the likely impacts of their decision, at the time they are making that decision.
 - *Transparency*. The information on which government regulatory decisions are based should be publicly available.
- 2.3 Central to the Australian Government's RIA process is the Regulation Impact Statement (RIS). 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 during the development of the proposal, and includes an assessment of the costs and benefits of each option (although RISs are not required to directly compare options).
- 2.4 The RIS must be presented to decision makers so that the decision is informed by a balanced assessment of the best available information.
- 2.5 After a decision has been made, the RIS needs to be made public. In general terms, this means that the RIS must be posted on the central online RIS register maintained by the Office of Best Practice Regulation (OBPR or 'the office') and, where applicable, tabled in parliament with the enabling legislation (attached to the explanatory material for bills or legislative instruments).
- 2.6 The OBPR administers the government's RIA requirements. The OBPR has a number of roles (Box 1), including: assisting and training agencies to quantify compliance costs, undertake cost-benefit analysis and prepare RISs; monitoring and reporting on compliance with the government's RIA requirements; and administering the Council of Australian Governments (COAG) guidelines for regulation making by national bodies.¹

¹ See COAG (2007), *Best Practice Regulation: a Guide for Ministerial Councils and National Standard Setting Bodies*, available from the OBPR website (www.finance.gov.au/obpr).

In the shaded sections of this chapter you will find guidance about working with the OBPR at each step of the RIS process.

Box 1 – 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 agencies on appropriate quality control mechanisms for the development of regulatory proposals and the review of existing regulations, including whether Regulation Impact Statements (RISs) are required
- examine RISs and advise decision makers whether they meet the government’s requirements and provide an adequate level of analysis, including cost-benefit and risk analysis of appropriate quality
- advise agencies on assessing business compliance costs and maintain the Business Cost Calculator (BCC) as a regulation costing tool
- manage other regulatory mechanisms, including Post-implementation Reviews and Annual Regulatory Plans
- 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 and consultation, and on regulatory reform developments generally
- maintain a central online public register of all RISs
- provide advice to ministerial councils and national standard-setting bodies on Council of Australian Governments guidelines that apply when such bodies make regulations, and
- monitor regulatory reform developments in the states and territories, and in other countries, in order to assess their relevance to Australia.

2.1 When does a RIS need to be prepared?

- 2.7 A RIS is mandatory for all decisions made by the Australian Government and its agencies that are likely to have a regulatory impact on business or the not-for-profit sector, unless that impact is of a minor or machinery nature and does not substantially alter existing arrangements. This includes amendments to existing regulation and the rolling over of sunseting regulation.
- 2.8 A RIS must be presented to the decision maker at the time the decision is made.

To whom do the arrangements apply?

- 2.9 The RIS requirements apply to all Australian Government departments, agencies, statutory authorities and boards (referred to collectively as ‘agencies’) that review or make regulations that have an impact on business or the not-for-profit sector, including agencies or boards with administrative or statutory independence. The agency responsible for bringing the proposal to the decision maker is also responsible for ensuring the RIS requirements are met. Agencies are also responsible for preparing and publishing an Annual Regulatory Plan in July each year.

Many non-Cabinet decision makers are governed by their own Acts, and are subject to additional checks and balances such as consultation requirements and appeal provisions. While the RIS requirements apply to all agencies, the OBPR considers these particular governance frameworks in determining how the RIA requirements should apply.

What is regulation?

- 2.10 Regulation is any ‘rule’ endorsed by government where there is an expectation of compliance. It includes primary legislation and legislative instruments (both disallowable and non-disallowable) and international treaties.² It also comprises other means by which governments influence businesses and the not-for-profit sector to comply but that do not form part of explicit government regulation (for example, industry codes of practice, guidance notes, industry-government agreements and accreditation schemes).
- 2.11 ‘Regulation’ does not include grant programs, government procurement of specific goods or services or government agreements unless these processes impose more general regulatory requirements on the organisations receiving funding or providing goods/ services.

What is an impact?

- 2.12 An impact is either a positive or negative effect, and covers items that can be readily quantified in monetary terms (e.g. service charges, subsidies, compliance costs) as well as items that cannot be readily quantified in monetary terms (for example, restrictions on competition).
- 2.13 ‘Business or the not-for-profit sector’ includes any organisation that aims to make a profit and the commercial activities or transactions of not-for-profit organisations.

² The term ‘treaties’ includes treaties, conventions, protocols, covenants, charters, agreements, pacts and exchanges of letters.

What is a minor or machinery change?

- 2.14 'Minor' changes refer to those changes that do not substantially alter the existing regulatory arrangements for businesses or not-for-profit organisations, such as where there would be a very small initial one-off cost to business and no ongoing costs. 'Machinery' changes refer to consequential changes in regulation that are required as a result of a substantive regulatory decision, and for which there is limited discretion available to the decision maker.

COAG processes

- 2.15 Ministerial councils and national standard-setting bodies are required by COAG to conduct regulatory impact analysis for agreements or decisions of a regulatory nature. These requirements are set down in the COAG-endorsed *Best Practice Regulation: A Guide for Ministerial Councils and National Standard Setting Bodies* (COAG 2007). 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. This Handbook does not apply to COAG processes.

2.2 The RIS process

- 2.16 Not all decision making processes are the same. They differ in duration, urgency, significance of impacts and the number of decision making points. Recognising this, the OBPR is required to interpret how the RIS requirements apply in each case. In essence, it will assess the extent to which the RIS promotes the three broad outcomes of sound analysis, informed decision making and transparency.
- 2.17 The RIS process depicted in Figure 1 reflects the development of a proposal with regulatory impacts that will be relevant in the majority of cases. The broad stages in the RIS process are:
- *Notifying the OBPR* of the proposed regulation
 - *Preparing the RIS* to support sound analysis
 - Informing the *decision making stage*, and
 - *Publication* to support transparency.

The role of the OBPR is to ensure that the RIS meets the requirements of adequacy as set out in Box 3. This requires the OBPR to determine that a range of alternative options has been identified for assessment including, as appropriate, non-regulatory, self-regulatory and co-regulatory options.

The OBPR is not required to assess the merits of individual policy options – its role, once an alternative range of options has been identified, is to assess the rigour with which the impact of each proposal has been assessed.

Notifying the OBPR

- 2.18 It is the agency's responsibility to contact the OBPR early in the decision making process. This should occur once an administrative decision has been made that regulation may be necessary, but before a decision on whether or not to regulate is made by the government or its delegated officials. There is no provision for the making of decisions for regulation 'in principle', subject to the preparation of a RIS.
- 2.19 For all proposals, regardless of the decision maker, initial discussions about a regulatory proposal may be undertaken without the need for a RIS as long as no decision to adopt a specific regulatory approach is made. For regulatory proposals before the Cabinet or a committee of the Cabinet, there is a requirement that the sponsoring minister write to the Prime Minister or Cabinet Secretary, copied to the Treasurer and the Minister for Finance and Deregulation, seeking agreement for the Cabinet to undertake initial discussions without the requirement for a RIS. Essentially, this allows for 'brain storming' without a RIS when no final decisions are made.

Once you become aware that a regulatory proposal you are working on may require a RIS, you should contact the OBPR.³ Engaging early with the OBPR ensures that you will have sufficient time to prepare the RIS, including the requirements for consultation and analysis. Each section of the OBPR deals with a suite of different portfolio areas and your enquiry will be directed to the appropriate area.

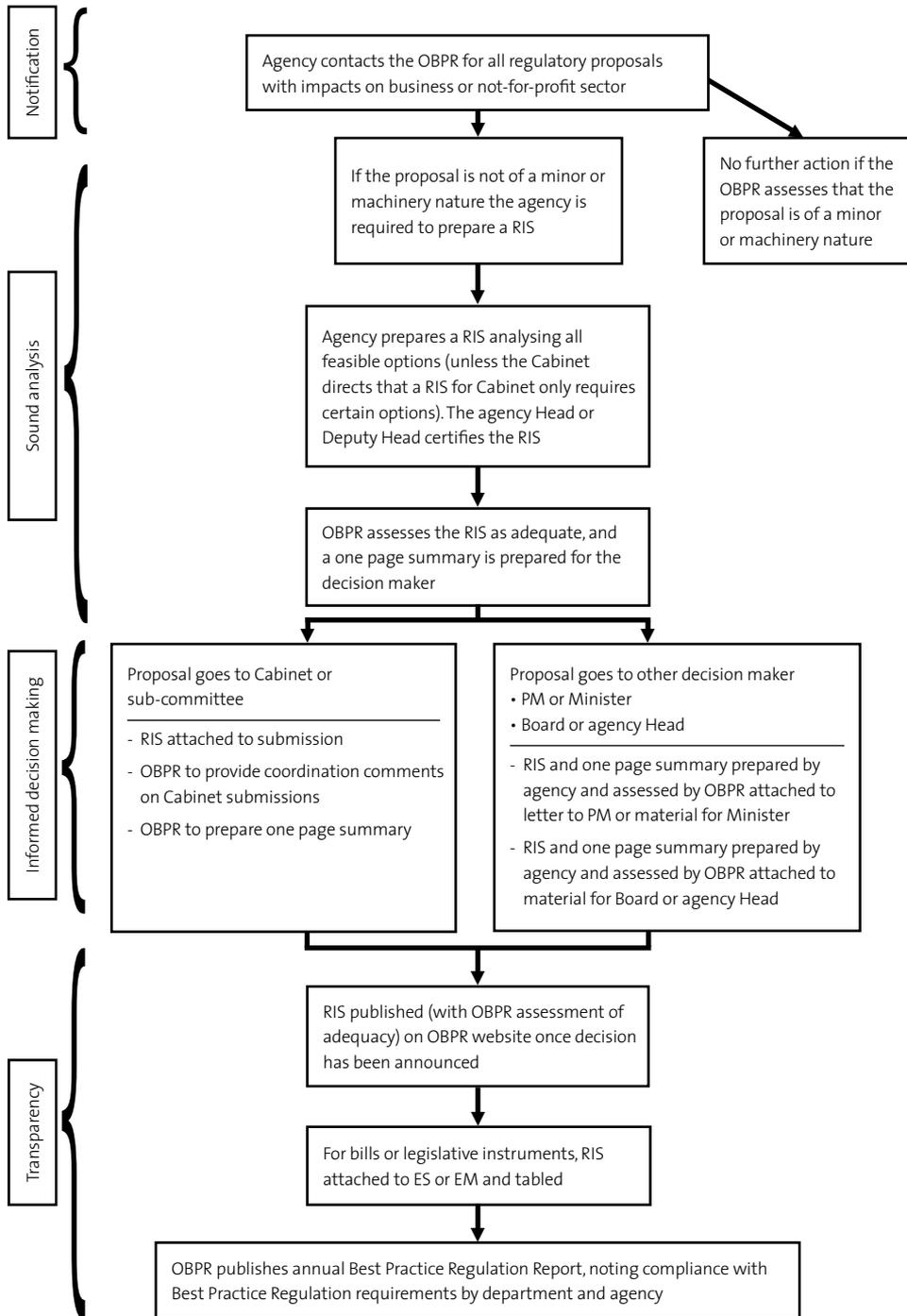
In addition, all agencies have a Best Practice Regulation Coordinator and you should make early contact with the relevant area in your agency when considering any new regulations.

Assessing whether a RIS is required

- 2.20 The OBPR is required to assess whether the proposal requires a RIS or whether it is minor or machinery in nature and does not require one. In order to make this assessment, the OBPR will require information in writing from the agency on what the proposed regulation entails and the likely impacts of the proposal. In general terms, the more the proposed regulation impacts on business operations, and the greater the number of businesses or not-for-profit organisations that will be affected, the more likely it is that a RIS will be required.

³ You can contact the OBPR by phone on (02) 6215 1955, or by email at helpdesk@obpr.gov.au.

Figure 1 – The RIS process



2.21 For multi-stage decision making processes (Box 2) more than one RIS may be required.

Box 2 – Multi-stage decision making processes

Occasionally a policy making process may include a number of distinct decision making stages. For example, a proposal presented to a decision maker for initial approval may return at a later stage for a final decision on the detailed implementation. Similarly, where an exposure draft of legislation is required, in most cases a decision (informed by a RIS) on a regulatory option has already been made. Consequently, a two-staged decision making process might occur.

A RIS is required at each significant decision making stage of the process. While the definition of 'significant' will vary from case to case, in general a decision making stage is significant when that decision precludes one or more options from further consideration.

Typically, entering into a treaty has multiple decision making stages (see page 22).

The OBPR officer assisting with your enquiry will generally require some information about the proposal before he or she can assess whether or not a RIS will be required. Because the 'trigger' for preparing a RIS depends on the nature of the impact of the proposal on business or the not-for-profit sector, the sort of information the office would find useful in its assessment includes:

- the nature of the proposal
- the intent of the proposal
- whether the proposal is likely to impact on business or not-for-profit organisations, either directly or indirectly
- the nature of the impacts – whether the proposal restricts the activities of certain businesses or whether it acts more indirectly, and
- the size of the likely impacts– how many businesses will be affected and whether there will be effects on the community more broadly.

At this stage, the information you provide to the OBPR does not need to be particularly detailed; it just needs to allow the OBPR officer to make an accurate assessment of what the likely impacts of the proposal might be.

To assist you in providing this information, a preliminary assessment form is available from the OBPR website (it is not compulsory for you to use this form).

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Once the OBPR officer has this information, he or she is able to make an assessment of whether the proposed regulation is likely to have an impact on business or the not-for-profit sector (and will require a RIS); or whether the impact is likely to be of a minor or machinery nature (and will not require a RIS).

The OBPR officer will base his or her assessment largely on the information you provide, so the more quickly you can provide accurate information, the faster you will receive the office's assessment.

The OBPR will notify you in writing of its assessment as well as who will be the contact officer for your proposal. The office will also advise you that you need to inform the OBPR if the proposal changes before the final decision is made. This could affect whether a RIS may be required when an initial assessment has suggested otherwise.

Small Business Advisory Committee

- 2.22 Where a proposal is likely to have significant impacts on small business, the agency should look to consult the Australian Government's Small Business Advisory Committee (SBAC). The SBAC can help the agency to assess the likely impacts of the proposal on small business in the RIS. Further information about the SBAC is at Appendix D.
- 2.23 If the OBPR determines that you need to prepare a RIS, and that the proposal may have a significant impact on small business, it will provide you with the contact details of the SBAC Secretariat (in the Department of Innovation, Industry, Science and Research).

Preparing the RIS

- 2.24 Preparing a RIS ensures that all relevant information to the decision making process is documented, and that the decision making processes are made explicit and transparent. While there is no set format for a RIS, it should generally contain seven elements, setting out:
1. the problem or issues that give rise to the need for action
 2. the desired objectives
 3. a range of options (regulatory and non-regulatory, as applicable) that may constitute feasible means for achieving the desired objectives
 4. an assessment of the impact (costs, benefits and, where relevant, levels of risk) of a range of feasible options for consumers, business, government and the community
 5. a consultation statement
 6. a conclusion and recommended option, and
 7. a strategy to implement and review the preferred option.

2.25 In addition to these seven elements:

- where a regulatory proposal restricts competition, agencies must demonstrate in the RIS that the preferred option generates a net benefit to the community as a whole and that the only way of achieving the government's objective is to restrict competition
- agencies may be given direction regarding which options to analyse in a RIS for the Cabinet or a committee of the Cabinet. This would require the sponsoring minister to write to the Prime Minister or the Cabinet Secretary, copied to the Treasurer and the Minister for Finance and Deregulation
- where a regulatory proposal implements a specific election commitment, the RIS should focus on the commitment and the manner in which the commitment should be implemented, not on the initial regulatory decision, and
- new or amended cost recovery arrangements must comply with the Australian Government's Cost Recovery Guidelines and relevant Finance Circulars.⁴

Once the OBPR determines that a RIS will be required, the level of analysis you will need to provide in the RIS will have to be commensurate with the likely impact of the proposal. That is, if the proposal is likely to have significant impacts on business and the community more broadly, you will need to provide a detailed analysis of those impacts; if the impacts are likely to be less significant, then a less detailed analysis will be required.

This requires a judgement about the likely impact of the proposal. Again, this is a subjective question, but the office takes a structured approach in assessing likely impacts. For each proposal the OBPR examines:

- the nature and magnitude of the proposal (and the problem it is addressing), and
- the scope of its impact.

It then uses this information to assign each RIS to one of four categories, 'A'-'D' (with 'A' representing the proposals with the largest likely impacts).

When assessing the scope of the proposal, the OBPR considers how broadly an impact will affect the community. An increase in the rate of excise on petrol would, for example, be quite broad in its impact, while a curfew on flights into a small airport would be relatively narrow in its impacts.

A complete ban on providing particular goods or services would be regarded as 'large' in magnitude, while an example of a less significant 'small' intervention might be an amendment to regular reporting requirements imposed on business.

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⁴ Online at www.finance.gov.au/financial-framework/. Advice on cost recovery issues can be directed to the Financial Framework Policy Branch, Department of Finance and Deregulation (Finframework@finance.gov.au).

Detailed guidance on how to prepare a RIS is included in part 3 of this Handbook. If you have any general queries on what issues should be addressed in the RIS, your OBPR contact officer will be able to provide advice.

The office is also able to provide detailed drafting advice as you prepare your RIS. It is recommended that you contact the OBPR as early as possible in the policy process to allow for the opportunity to provide detailed advice on at least one draft of your RIS.

Assessment of adequacy by the OBPR

- 2.26 The RIS must be certified by the relevant departmental secretary or deputy secretary (or agency head/deputy head) prior to being passed to the OBPR for final assessment. The office is able to provide early drafting advice to officers preparing RISs, but will only formally assess the adequacy of a RIS once it has been certified. If the OBPR formally assesses a RIS as not adequate, the office will provide clear and timely advice to the agency on the reasons for the OBPR's view.

You will need to provide evidence to the OBPR that your RIS has been certified by the relevant officer. A template form for this purpose is available from the OBPR's website at www.finance.gov.au/obpr.

- 2.27 To be assessed as adequate, a RIS must have 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 proposal. Subject to this principle, the criteria which will be used by the OBPR to assess whether a RIS contains an adequate level of information and analysis are specified in Box 3.

Box 3 – Criteria for assessing the adequacy of a RIS

1. Problem

The RIS should clearly identify the problem(s) 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
- identify the relevant risks, if the problem involves risk, and explain why it may be appropriate for the government to act to reduce them, and
- present a clear case for considering that additional government action may be warranted, taking account of existing regulation and any risk issues, and the potential for market developments to overcome the problem.

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2. Objectives

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

3. Options

The RIS should identify a range of alternative 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. If the Cabinet directs that a limited set of options be considered, or options are limited because the regulation relates to an election commitment, this must be clearly stated.

4. Impact analysis

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

- 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, using the status quo as a baseline
- assess the net impact of each option on the community as a whole, taking into account all costs and benefits
- assess the impacts on business and the not-for-profit sector, including distributional issues such as the impact on small business, and quantify (using the Business Cost Calculator, Tax Compliance Cost Calculator, or equivalent approved by the OBPR) the effect of each option on business compliance costs
- recognise the effect of the options on individuals and the cumulative burden on business
- quantify other significant costs and benefits to an appropriate extent, taking into account the significance of the proposal and its impact on stakeholders
- analyse the extent to which each option would reduce the relevant risk if an objective of regulation is to reduce risk, and the costs and benefits involved
- 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 regulation results in a net benefit and that the government's objective/s can be achieved only by restricting competition, and
- provide evidence in support of key assumptions and clearly identify any gaps in data.

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5. Consultation

The RIS should:

- outline the consultation objective
- describe how consultation was conducted (including when 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 as to why not.

The consultation process reported in the RIS should conform to the government's best practice principles and policy on consultation (Appendix C).

6. Conclusion and recommended option

The RIS should clearly state the preferred option, why it is preferred, and indicate the costs and benefits of this option. This statement needs to be supported by the analysis contained in the RIS.

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.

In addition to the assessment criteria listed in Box 3, the OBPR will consider a number of broader questions when assessing whether your RIS meets the government's requirements:

- Is the RIS well written? Does it have a logical structure and is it relatively free from technical jargon? Does it contain any extraneous information?
- Is the RIS transparent? Does it contain all of the relevant information in analysing the likely impacts of the proposal?
- Does the RIS clearly outline the problem? Does it describe why government intervention is necessary?
- Is the RIS a balanced document? Does it appropriately identify any uncertainties in the analysis (both in the preferred and alternative options) and does the strength of the conclusions reflect these uncertainties? Are the views of dissenting parties as well as those who agree with the proposal reflected appropriately?

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Most RISs require more than one draft to meet the test of adequacy and as such you should factor more than one iteration into your schedule. You should let your OBPR contact officer know about any relevant deadlines as early as possible as the officer will look to work within your deadlines if at all possible.

The OBPR will provide formal written advice of its assessment, as well as advice for improving the RIS to an adequate standard if the RIS is assessed as inadequate.

One page summary

- 2.28 A one page summary of the RIS must be prepared for decision makers. The OBPR will prepare the summary for proposals considered by the Cabinet or a committee of the Cabinet. For other proposals, the agency will prepare the summary in consultation with the OBPR; the summary will need to be approved by the OBPR as a fair, balanced and accurate summary of the adequate RIS.
- 2.29 The summary will include a brief description of the main points of the RIS, including the impacts of the preferred option, the affected stakeholders and the alternative options. It will also assess the extent to which the preferred option reduces business compliance costs and improves productivity growth. It is not necessary to publish the one page summary with the RIS.

The decision making stage

- 2.30 The government has agreed that, in the absence of exceptional circumstances as agreed by the Prime Minister, a regulatory proposal with likely impacts on business or the not-for-profit sector that are not minor or machinery cannot proceed to the Cabinet or other decision makers unless it has complied with the government's RIA requirements. The OBPR is required to advise decision makers on the adequacy of the RIS.

Proposals considered by the Cabinet and sub-committees of the Cabinet

- 2.31 A RIS assessed as adequate by the OBPR must be included in documentation circulated to agencies preparing coordination comments. The RIS should be available to decision makers, preferably attached to the final submission or memorandum. Policy officers should consult the *Drafter's Guide: Preparation of Cabinet Submissions and Memoranda* for guidance on completing the regulatory impacts section of the summary of the submission or memorandum.
- 2.32 The OBPR will comment on compliance with the government's RIS requirements and the adequacy of the RIS in its coordination comments.
- 2.33 The Cabinet Secretariat provides a gate-keeping role to ensure that regulatory proposals coming to the Cabinet and sub-committees of the Cabinet meet the RIS requirements. The Cabinet Secretariat will not circulate final Cabinet submissions or memoranda, or other Cabinet papers, without adequate RISs unless the Prime Minister has deemed that exceptional circumstances apply.

Proposals requiring approval from the Prime Minister

- 2.34 Where approval is sought from the Prime Minister, the RIS and the OBPR's advice about its adequacy, as well as the summary of the RIS, must accompany the letter to the Prime Minister seeking approval.

Other proposals

- 2.35 Where regulatory action requiring a RIS does not need approval from the Cabinet or the Prime Minister, the RIS, the OBPR's advice about its adequacy and the one page summary should be included in material presented to the decision maker (minister, board, committee or senior official).

Publication

- 2.36 The OBPR maintains a central online public register of all RISs including those assessed as inadequate. RISs and the OBPR's assessments of RISs will be published on the register as soon as practicable from the date of the regulatory announcement, in consultation with the agency.

In practice, publication on the OBPR's central RIS register will generally occur as soon as possible after the decision is publicly announced (for example, by media release). To assist in this process, you should notify the OBPR when this occurs.

The OBPR will obtain your agency's approval before publishing the RIS, and your agency will have control over the version of the RIS to be published (in consultation with the OBPR). The published RIS should reflect, subject to the exceptions discussed below, the RIS provided to the decision maker.

The OBPR will publish its assessment of the RIS where formally assessed. Where no RIS is prepared, the RIS is not formally assessed, or when the agency does not grant approval for publication, the office will make this clear on the RIS register.

- 2.37 Where a regulation is tabled in parliament, the RIS prepared at the decision making stage must be included in the explanatory memorandum (for primary legislation) or the explanatory statement (for legislative instruments). RISs for treaties will be tabled along with the National Interest Analyses.
- 2.38 There is scope for RISs to be modified after the decision maker's consideration but prior to publication:
- where a draft RIS refers to commercial-in-confidence or national security information, or
 - to include analysis of the option adopted where that option was not considered in the original RIS.
- 2.39 While it may be possible to add further information to give greater context to the decision, as a general principle information on the options considered will not be able to be removed. Any changes to the RIS intended for publication need to be approved by the OBPR.

2.3 Other requirements and information

Exemptions from the RIS requirements

- 2.40 Exemptions from the RIS requirements for exceptional circumstances can only be granted by the Prime Minister in writing. The OBPR must be informed when an exemption is granted and must be provided with a copy of the letter signed by the Prime Minister granting the exemption. If the Prime Minister grants an exemption, the agency will not be deemed as non-compliant with the RIS requirements.
- 2.41 If the decision results in legislation, the fact that an exemption was granted by the Prime Minister should be noted in the explanatory material. A post-implementation review (see below) is required for decisions for which the Prime Minister grants exceptional circumstances; this review is required to commence within one to two years from the date the regulation is implemented.

Post-implementation reviews

- 2.42 Where a proposal proceeds (either through the Cabinet or another decision maker) without an adequate RIS, the resulting regulation must be the subject of a post-implementation review (PIR). The review must commence within one to two years of the regulation being implemented, and will be required regardless of whether or not an exemption from the RIS requirements for exceptional circumstances was granted by the Prime Minister.
- 2.43 While the terms of reference for each review will depend on individual circumstances, the review should generally be similar in scale and scope to what would have been prepared for the decision making stage. Issues that could be examined include:
- the problem that the regulation was intended to address
 - the objective of government action
 - the impacts of the regulation (whether the regulation is meeting its objectives), and
 - whether the government's objectives could be achieved in a more efficient and effective way.
- 2.44 The key difference between a PIR and an analysis prepared prior to implementation is that, in the case of a review, the agency can report accurately on the implementation of the regulation and its actual impacts. Agencies should gather data from business and other stakeholders on the actual impacts of the measure, including compliance costs.
- 2.45 The PIR should incorporate consultation in line with the Australian Government's consultation principles (Appendix C). The level of consultation should be commensurate with the significance of the measure under review. Ideally, where appropriate and required, agencies should establish consultative arrangements well before the review is due in order to gather relevant data in preparation for the review.

- 2.46 Agencies are required to list upcoming PIRs (including proposed timelines) in their Annual Regulatory Plans (see Appendix B). Where agencies share joint responsibility for a PIR, the review should be listed on each responsible agency's Annual Regulatory Plan.
- 2.47 As with a RIS, the PIR must be certified by the relevant departmental secretary or deputy secretary (or agency head/deputy head) prior to being passed to the OBPR for final assessment. The review must be sent to the relevant portfolio minister and the Prime Minister, and will be published on the OBPR's central online RIS register. The OBPR will report on compliance with the PIR requirements in the Best Practice Regulation Report.

Election commitments

- 2.48 RISs are required for election commitments that are likely to have an impact on business or the not-for-profit sector unless the impact is minor or machinery in nature. When a proposal implements a specific election commitment, however, the RIS should focus on the commitment and the manner in which the commitment should be implemented. That is, the RIS does not need to revisit the initial regulatory decision and is not required to examine alternative options to the commitment. This should be made clear in the RIS.

RIS requirements for treaties

- 2.49 Treaties that are likely to involve domestic regulation that will impact on business or the not-for-profit sector require a RIS unless the resulting regulation is of a minor or machinery nature.
- 2.50 When 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 levels of risk. The RIS for entry into negotiations is not published.
- 2.51 When endorsement is sought to sign the final text of a treaty, the RIS would need to include a more detailed analysis that assesses the likely impacts on different groups within the Australian community, including business, consumers and governments.
- 2.52 As part of the transparency stage, the RIS for the treaty is tabled or made public with the final text of the treaty and National Interest Analysis.
- 2.53 A further 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, a RIS may be required for the domestic legislation if there is any discretion about the nature of the action to be taken to implement the treaty.
- 2.54 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*.

The OBPR recognises that there are a large number of different treaty negotiation processes. The OBPR will take the particular circumstances of each treaty process into account, while still observing the principles of sound analysis, informed decision making and transparency.

You should contact the office as early as possible to discuss the application of the RIA requirements to your treaty proposal.

Trade Impact Assessment

2.55 Where a proposed regulation has a direct bearing on export performance, a Trade Impact Assessment should be incorporated into the RIS. The assessment should summarise the impact of regulatory options and proposals on exporters and importers, and assess the overall impact on Australia's international trade.

Consequences of non-compliance

2.56 The government has agreed that no regulatory proposal should go to the Cabinet or any other decision maker unless it has complied with its RIS requirements, as advised by the OBPR.

2.57 Where the OBPR determines that a regulation may have been introduced or amended without a RIS, it will in the first instance contact the agency to obtain additional information. Following consultation with the agency, the OBPR will determine that either:

- the best practice regulation requirements have been met and no further action is required, or
- the requirement to prepare a RIS has not been met and the agency must undertake a post-implementation review. In addition, the agency will be reported as non-compliant on the OBPR online RIS register and in the *Best Practice Regulation Report* for that year.

As part of its role to report on compliance with the Best Practice Regulation requirements, twice a year the OBPR will ask each agency to prepare a list of all regulation made during the previous six months. The office will review all regulation made to ensure that where a RIS was required, these requirements have been met.

In addition to asking agencies about their regulatory activity, the OBPR also monitors regulations tabled in parliament and news reports, media releases and other sources for indications that a regulatory decision has been made. Where the office determines that a regulation may have been introduced or amended without the appropriate level of analysis being undertaken, it will in the first instance contact the agency to obtain additional information.

In the event that the OBPR confirms that a regulatory decision was made without the appropriate level of supporting analysis, the office will report this on the central RIS register, and in its annual *Best Practice Regulation Report*.

The OBPR's ongoing engagement with agencies

The office conducts training programs to assist agencies to prepare RISs, use the Business Cost Calculator (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.

More broadly, the OBPR aims to help agencies comply with the RIA requirements by promoting awareness of the requirements, and by seeking to better understand the policy-making environment faced by individual agencies. Best Practice Regulation Coordinators located in each agency can assist by acting as a contact point for further information on the RIS process.

Box 4 – Regulation Impact Statements – Frequently Asked Questions

Are RISs required for COAG or ministerial council decisions?

Yes – but there is a separate set of requirements for decisions made by COAG or ministerial councils. These are summarised in the COAG publication *Best Practice Regulation: a Guide for Ministerial Councils and National Standard Setting Bodies*, available from the OBPR website (www.finance.gov.au/obpr).

Are RISs only required for primary legislation or legislative instruments?

No – RISs are also required for international treaties and for other requirements that governments impose on business or the not-for-profit sector but that do not form part of explicit government regulation (such as industry codes of practice, guidance notes, industry-government agreements and accreditation schemes).

Is a RIS required if someone other than the Cabinet is making the decision?

Yes – RISs are required for all decision makers, including committees of the Cabinet, ministers, delegated officials or heads/boards of statutory agencies.

Is it true that RISs are not required for election commitments?

No – RIS requirements apply to election commitments that involve regulation. Where a proposal implements a specific election commitment, the RIS should focus on the commitment and its implementation, and not on the initial regulatory decision.

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Are RISs required for Budget proposals?

Yes – RIS requirements apply to all regulatory decisions whether or not they are made as part of the Budget process.

Is a RIS required for new regulations only and not for amendments to regulations?

No – RIS requirements apply to both new and amended regulations, including the rolling over of sunsetted regulations.

Is it true that RISs only have to consider the impacts on business or the not-for-profit sector?

No – once a proposal triggers the RIS requirements, the RIS must consider the impacts on all relevant groups, including consumers, governments and the broader community.

Is it true that a RIS is only required if the regulation imposes compliance costs?

No – a RIS is required if a regulatory decision is likely to impact on business or the not-for-profit sector. This impact includes items that can be readily quantified in monetary terms (like compliance costs, service charges or subsidies) as well as items that cannot be readily quantified in monetary terms (for example the costs of pollution).

Is a RIS required even when the regulation will provide a benefit to business or the not-for-profit sector?

Yes – a RIS is required for regulatory decisions likely to have any impact (whether positive or negative) on business or the not-for-profit sector unless the impact is of a minor or machinery nature.

Is a RIS only required at the policy implementation stage?

No – RIS requirements apply to all decisions in a policy process, whether they are broader decisions, or decisions on the detailed implementation of the policy.

Is a RIS only required for tabling?

No – a RIS is required to be presented to decision makers as they make their decision.

What role does the Small Business Advisory Committee (SBAC) have in the RIS process?

The SBAC's role is limited to those RISs that are likely to have a significant impact on small business. The SBAC will assist the agency in assessing the impacts of the proposal on small business. If a regulatory proposal being developed by your agency is likely to be particularly burdensome for small business, you should contact the SBAC Secretariat at an early stage.

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Does a RIS need to examine non-regulatory options?

Yes – if non-regulatory options can feasibly address the government’s objectives they should be included in the RIS.

If the benefits are difficult to value does the RIS still need to have a cost-benefit analysis?

Yes – even though it can be very difficult to place a monetary value on some factors, including environmental and social impacts. The cost-benefit analysis should recognise this and include a qualitative discussion of these impacts so that they can be compared with other impacts that can be more easily quantified.

Does the RIS need to demonstrate that the preferred option has the greatest net benefit?

No – the RIS must describe the impacts of all the feasible options and identify the preferred option but, unless the option restricts competition, it is not necessary to demonstrate that the preferred option has the greatest net benefit to the community.

Do the RIS requirements apply to changes in taxation?

Yes – a RIS is required for all regulatory decisions, including changes in taxation, likely to have any impact (whether positive or negative) on business or the not-for-profit sector unless the impact is of a minor or machinery nature or, in the case of taxation, purely revenue in nature.

3. PREPARING A REGULATION IMPACT STATEMENT

- 3.1 This chapter provides general advice on how to prepare a RIS. In doing so, the OBPR has tried to offer practical guidance which addresses the wide range of issues covered by Australian Government regulatory proposals. However, developing good quality regulation is a complex undertaking, and the realities of policy development will often not conform to 'textbook' examples of policy analysis. As a result, there will be times when agencies will need to exercise their own judgement about how best to give effect to the intent of the RIS requirements in a given situation. OBPR officers are also available to help apply the following guidance to individual circumstances.

A hypothetical example, based on the introduction of graphic warning images on cigarette packages⁵, is used to illustrate some of the concepts discussed in this chapter.

3.1 General comments on preparing a RIS

- 3.2 The purpose of a RIS is twofold: to allow decision makers to be informed by a balanced assessment of the best available information; and to inform the community about both the likely impact of the proposal and the information that was taken into account by the decision maker. As such, it is important that you draft the RIS with these audiences in mind: it should not be overly technical or contain extraneous information, and it needs to provide a balanced assessment of the various options rather than advocate the preferred option.
- 3.3 There is no fixed length for a RIS; the emphasis should be on quality rather than quantity. However, the level of detail included in a RIS needs to be commensurate with the complexity and significance of the problem being addressed. While the RIS should be a stand-alone document, in some cases it could be useful to place technical or detailed background material on the sponsoring agency's website and cross-reference it in the RIS.
- 3.4 Examples of RISs are available on the OBPR website (www.finance.gov.au/obpr). If you have any questions or require assistance, please contact the office.

Use of consultants

- 3.5 Some agencies use consultants to prepare RISs, particularly for analysis of highly complex issues where agencies consider that they may not have the required technical skills available. While employing consultants can improve the quality of the analysis in a RIS, it can also reduce the quality of options under consideration. One of the objectives of the RIS process is to encourage you to question the effectiveness and efficiency of the policies being developed; where this role is outsourced to an external consultant there is a risk that agencies may not have a good understanding of the options being presented.

⁵ See Applied Economics (2003).

- 3.6 The RIS remains the responsibility of the agency even where consultants are used. The OBPR will primarily deal with the agency responsible for the RIS rather than with the consultants preparing the RIS, and will generally address its comments and concerns with the RIS directly to you.

3.2 Assessing the problem

- 3.7 Early in the RIS, you should describe the problem or issue that has prompted a consideration of government action. You should provide information 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. Box 5 provides further guidance.

Box 5 – 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, 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?

What is the nature of the problem – what is the loss, harm or other adverse consequence that is being experienced, and by whom?

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

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?

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Assess the consequences of *no action*

What are the consequences of not taking any 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?

- 3.8 When identifying the nature and size of the problem you should refer to empirical evidence where available, as well as perceptions of the problem. If the problem involves risk to the public, businesses, workers or the environment, you should include a description of the hazard and a discussion of the likelihood that it will occur (see Appendix F for an introduction to risk analysis). This should include assessing the worst and best outcomes that could occur if a 'do nothing' approach is taken.

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

- 3.9 The existence of a problem may justify government regulation or other intervention. However, you need to describe why the government's involvement is required to deal with the identified problem. In addressing this issue, a number of questions should be considered:
- Is the problem one that the government has the capacity to deal with effectively?
 - Is the problem a consequence of existing regulation?
 - 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?
- 3.10 The economic concept of 'market failure' can provide a rationale for government action. Market failure refers to situations where markets do not produce economically efficient outcomes and can arise for a number of reasons including: where the existence of a large firm (or firms) restricts competition in a market; where consumers do not have adequate information about a good or service; or where pollution or other factors affect third parties. The types of market failure are discussed in Box 6.
- 3.11 If the justification for government action is based on market failure, you should identify the precise nature of the market failure. 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).

- 3.12 While the existence of market failure indicates that there may be a role for government action to make the community better off, you still need to consider whether the market failure is significant enough to justify government regulation. If the market is well functioning in terms of producers and consumers being able to exchange information on the costs of resources and the value of goods and services, and if there is a reasonable level of competition, then you may have difficulty justifying regulation on efficiency grounds.

Box 6 – 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 and can provide a strong rationale for government intervention.

Market failure, by itself, does not indicate that government intervention is warranted, particularly if the failure does not materially impact on the functioning of the market. In such cases the costs of intervention may outweigh any benefits. Moreover, there are legitimate rationales for government intervention that do not depend on market failure; for example, the delivery of social policy outcomes. 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. Market 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.

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.

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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 for or costs that are not compensated through market prices. For example, a person receiving a flu vaccination reduces the chances of other people falling ill. Alternatively, individuals may choose to drive on already congested roads, increasing 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 it at relatively low cost.

Public goods

Some goods and services, by their very nature, are unlikely to be provided to a socially optimal level by the private market. Goods or services which have the following characteristics may be undersupplied without government intervention:

- *Non-rivalrous*: when one person's consumption of that good or service does not affect the ability of others to also consume the good or service
- *Non-excludable*: when it is difficult to exclude people from consuming the good or service. It is difficult to charge consumers a price for non-excludable goods or services

Public goods are both non-rivalrous and non-excludable. They include examples such as national defence and lighthouses.

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

Is there relevant regulation already in place?

- 3.13 Governments may previously have taken action to address the underlying problem. Where this is the case, you should document the characteristics of existing regulation at all levels of government (federal, state/territory and local), and identify the responsible regulatory organisations and relevant government policy. You should demonstrate whether or not existing regulation has been effective in addressing the problem.
- 3.14 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?

Cigarette packaging example: the problem

In this example, the RIS would point out that smoking is a leading cause of death and disease in Australia, and present data on the incidence and distribution of health impacts.

A number of factors contribute to a strong case for (continued) government action to reduce smoking rates, including:

- evidence that passive smoking causes health problems for third parties
- the use of community health resources by smokers, and
- evidence that many smokers would quit if they could.

The RIS would quote or reference relevant studies that would support these conclusions.

The government is already heavily involved in reducing the incidence of smoking, including by:

- regulation of the production, sale and advertising of cigarettes
- imposing significant excise duties on cigarettes, and
- funding anti-smoking campaigns.

The government also requires that health warnings be placed on cigarette packages. Evidence suggests, however, that the effectiveness of such warnings is declining, and that graphic warnings may be more effective.

Again, the RIS needs to include evidence about changes in the effectiveness of the warnings. In the event that evidence is not available, the RIS would need to be clear that this was a perceived problem which cannot be substantiated.

3.3 Objectives of government action

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

- 3.15 In this step of the RIS you should clearly 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 outputs, or means of obtaining it. For example, a broad objective of government transport regulation may be ‘to reduce the costs associated with traffic accidents’. This objective differs from a narrower objective of ‘mandating the use of seatbelts’, which is one of many means of attaining the broader objective.
- 3.16 The aim of this part of the RIS is not to pre-justify a preferred solution, but to specify the objective broadly enough so that all relevant alternative solutions can be considered. However, you should avoid making it 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.
- 3.17 Other information you could provide at this point includes, if applicable:
- any distinction between the primary and subsidiary objectives of the proposal
 - whether outcomes are subject to constraints; for example, if they must be achieved within a certain timeframe, and
 - whether there is an authoritative basis for the proposal to review regulations; for example, a relevant Cabinet minute or government policy announcement.

Cigarette packaging example: the objectives

The broad objective of government action is to further reduce the incidence of smoking in the Australian community. A secondary objective is to increase the effectiveness of warnings about the health impacts of smoking.

While the RIS could also include an overriding objective about improving the health of Australians, the two objectives above provide a more precise basis on which to judge the policy options.

3.4 Options that may achieve the objectives

- 3.18 This section of the RIS needs to set out the practical alternative options that could wholly or partly achieve the identified government objectives. You should describe each alternative option and explain how the option, if implemented, would achieve the desired result.

- 3.19 For decisions made by the Cabinet or a committee of the Cabinet, the agency may be directed by the sponsoring minister as to the range of options considered in a RIS, with the agreement of the Prime Minister or the Cabinet Secretary (and copied to the Treasurer and the Minister for Finance and Deregulation). And in the case of specific election commitments, the RIS may focus on the commitment and not consider alternative options. In both cases, you will need to make clear in the RIS that the options considered have been limited and that the appropriate authority has been obtained.

Identify a range of feasible options

- 3.20 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, you need only cover those options that are reasonably likely to achieve the government's objectives. Infeasible options do not need to be considered in detail in the RIS, however you may need to explain why these options are not feasible.
- 3.21 If any of the options involve establishing or amending standards in areas where international standards apply, you should indicate whether the standards under consideration deviate from the relevant international standards. If this is the case, you should provide an explanation for the variation and examine the implications of this variation.

Alternative regulatory forms

- 3.22 *Self-regulation* is generally characterised by industry-formulated rules and codes of conduct, with industry solely responsible for enforcement. You might assess self-regulation as a feasible option if:
- there is no strong public interest concern, in particular no major public health and safety concerns
 - 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).
- 3.23 Self-regulation is not likely to be effective if industry has an incentive not to comply with the rules or codes of conduct.
- 3.24 *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.

- 3.25 *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 often referred to as the ‘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.
- 3.26 *Explicit government regulation* – sometimes referred to as black letter law – comprises primary and subordinate legislation. It is the most commonly used form of regulation.
- 3.27 You could consider explicit government regulation 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), or
 - 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.

Alternative instruments

- 3.28 Within each form of regulation, you could consider using a number of alternative instruments. Alternative instruments (only some of which will be relevant for a particular type of regulatory form) may include:
- no specific action (that is, relying on the market in conjunction with existing general liability 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.
- 3.29 The RIS requirements may apply for any standards used for regulatory purposes, even if they have been developed by Standards Australia or other third parties.

Cigarette packaging example: the options

Feasible options available to the government are:

- the status quo
- introduce graphic warnings – this would require cigarette manufacturers to insert graphic photos of some of the health impacts of smoking, in a form to be stipulated by legislation, or
- start a new public information campaign on the dangers of smoking

Due to the high risk of death and disease posed by smoking, and the past failure of self-regulatory approaches, self-regulation is not considered a feasible alternative in this instance. It is important that the RIS rules out infeasible options at this stage, rather than waste time demonstrating their ineffectiveness in the impact analysis.

3.5 Impact analysis – costs, benefits and risks

- 3.30 The next step in drafting a RIS is to conduct a comprehensive assessment of the expected impact (costs and benefits) of each feasible option. Your objective here is to inform decision makers on the likely merits of available options, and thereby assist their decision.
- 3.31 When analysing each option, you 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, quantify the impacts; at a minimum, your analysis should attempt to quantify all highly significant costs and benefits. All assessments of costs and benefits, whether quantitative or qualitative, should be based on evidence, with data sources and assumptions clearly identified.
- 3.32 Most RISs use the status quo as the benchmark for assessing the impact of each option. Adopting this approach will allow you to clearly identify the costs and benefits that would result from implementing the preferred option.
- 3.33 To assess the costs, benefits and the level of risk associated with each option, you need to present a clear picture of how each option would change the status quo. Accordingly, your analysis should clearly explain how the actions, obligations and circumstances of different stakeholder groups are likely to change if the option is implemented.
- 3.34 If you have described the options in relatively general terms in the 'Options' section of the RIS, you may need to provide a more detailed description of what each option will entail in the 'Impact Analysis' section.

Is a formal cost-benefit analysis required?

- 3.35 Not necessarily. The OBPR will provide you with 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 overall effects. For example, a comprehensive and detailed qualitative analysis, supported by quantitative evidence where it is available or readily obtained, may be adequate if the impacts of the proposal are not likely to be highly significant. In such cases, the time and expense involved in additional quantitative analysis may not be justified.
- 3.36 However, for major proposals, you will be required to provide a greater level of quantification in the RIS, and a full cost-benefit analysis may be appropriate. See Appendix E for more information on quantitative cost-benefit analysis.

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

- 3.37 You will need to clearly identify all groups affected by the problem and its proposed solution, whether directly or indirectly affected. In addition, you should assess the effects on the community as a whole, such as environmental and social impacts.
- 3.38 A common misperception is that a RIS is a 'business impact statement'. While an impact on business is a trigger for preparing a RIS, you need to consider the impact of an option on all affected groups in the community.
- 3.39 Groups should generally be distinguished as consumers, business and government. Depending on the nature of the proposal these groups may 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 can be made along industry or sectoral lines, by type of activity, or by size of business, and
 - within government, whether impacts are at the federal, state/territory and/or local government level.
- 3.40 The extent to which groups need to be separately identified in a RIS will vary according to the problem and option being assessed.

Identify the expected costs and benefits of the options

- 3.41 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 well-being. Cost items may 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.
- 3.42 Once you have identified the costs and benefits to each of the affected parties, you should assess the net impact of each option on the community as a whole.

Costs

- 3.43 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.
- 3.44 In order to help you quantify business compliance costs, the OBPR has developed the Business Cost Calculator (BCC), which is described in Appendix G.
- 3.45 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.
- 3.46 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.

3.47 And costs to government may include:

- the costs of developing the regulation
- running education campaigns/providing information
- administration of licensing/inspection services
- collection and collation of business information, and
- enforcement costs, including the costs of litigation.

Benefits

3.48 You should identify and describe the benefits of the options to business, consumers, government, other affected groups and the community at large. Many benefits may not be readily quantifiable. 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.

Distribution of costs and benefits

3.49 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, with the costs being borne by a large number or by those who can least afford it. In considering the net impacts of each option, however, you must be careful to avoid double counting: for example, if a cost to businesses is passed on to consumers, you should count this cost only once when estimating the net impact.

Small business

3.50 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 resources professionals) with detailed knowledge of regulation. While such impacts may be unavoidable (indeed they may be desirable), it is important that decision makers are aware of all impacts on small business.

3.51 You could consider the degree of impact on individual small businesses, the number of small businesses affected, and whether the overall impact on small business is in proportion to the impacts on other businesses or groups. It is important that you pay particular attention to the compliance cost impact on small business, and the ability (or inability) of these businesses to absorb such costs. The Small Business Advisory Committee (see Appendix D) can assist you in assessing the impact on small business.

Quantify the impacts where they are significant

3.52 You will need to accurately and objectively quantify impacts where this is possible. In general, the standard for quantification is higher for proposals which potentially have a significant impact on business.

3.53 Quantification:

- provides comprehensive and comparable information to decision makers
- encourages close examination of the nature and impact of costs and benefits
- encourages reduction in the costs associated with regulation
- clarifies the essential assumptions and judgements that underpin the decision about the preferred option, and
- can provide a basis for consultation with stakeholders.

3.54 The accuracy of quantified estimates may often be uncertain, and you may have made a number of assumptions in order to generate quantified estimates. While these can reduce confidence in the estimates, it is important that you still include these in the RIS (to give decision makers as much relevant information as possible). Appropriately qualifying and explaining your approach is important, including why better estimates are not achievable.

3.55 Some costs and benefits are difficult to quantify. These impacts still need to be considered; the challenge is to assess unquantified impacts adequately. For example, suppose a regulation is proposed that would have quantifiable costs and benefits in addition to unquantifiable benefits. It may be possible for you to assess the net effect of the quantified impacts and compare this to a qualitative assessment of the remaining (unquantified) benefits; you may be able to make a persuasive argument that these benefits are worth paying the costs.

3.56 If a regulatory proposal involves addressing a risk, such as OH&S laws targeted at reducing the risk of workplace injury and death, quantifying the impacts can be done within a risk analysis framework. See Appendix F for an introduction to risk analysis.

Cigarette packaging example: impact analysis

The RIS would examine the impacts on the main stakeholders of each of the feasible options. In the case of the graphic warnings on cigarette packages, these would be:

- smokers - those who quit are likely to receive health benefits, longer lives, and lower health costs. Those that do not quit would be worse off for having to look at the graphic warnings.
- tobacco companies - are likely to incur higher costs as a result of having to print graphic warnings. They will also receive lower profits, to the extent that smokers quit as a result of the warnings.
- government - will incur the costs of implementing and enforcing the regulation, and will receive lower excise to the extent that smokers quit as a result of the warnings. Governments are likely to incur lower public health costs as a result of smokers quitting.
- community - lower rates of smoking will result in reduced health impacts of passive smoking, and reduced demand for public health resources.

Given that this proposal is likely to affect a lot of people and will involve high compliance costs for tobacco companies, the impacts will need to be quantified. In this case, the impacts are readily quantifiable (Applied Economics 2003).

Identify the data sources and assumptions used, and any gaps in data

- 3.57 You need to include the sources of data used in the analysis, as well as identify any assumptions made when conducting the impact analysis. In this way, the reasoning behind the conclusions is made transparent.
- 3.58 This applies to both quantitative and qualitative information included in the impact analysis. In the case of quantitative information, you should cite specific sources and explain how data were derived from those sources. Where you have included qualitative assessments of costs and benefits, you should explain the evidence and reasoning on which they are based. All assertions and conclusions in the RIS need to be supported by evidence.
- 3.59 The RIS should clearly flag any gaps in the data underpinning the analysis and any assumptions that have been made. Where there is significant uncertainty about any key data inputs, the RIS will benefit from a sensitivity analysis that considers outcomes for a range of values (see the discussion of sensitivity analysis in Appendix E).

Restrictions on competition

- 3.60 Some existing and proposed regulations restrict competition. Such regulations can restrict consumer choice, raise prices and reduce overall economic productivity by denying the economy the efficiency gains competition provides. Significant restrictions on competition 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.
- 3.61 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.
- 3.62 Where your particular proposal restricts competition, the RIS must demonstrate that it will deliver benefits to the community that outweigh its costs, and that there are no alternative means of achieving the same objective without restricting competition. This is required to meet the Australian Government's commitments under the intergovernmental Competition Principles Agreement, which is designed to promote competition in the economy and the benefits that it can bring to the community.
- 3.63 The competition checklist set out in Box 7 provides a guide to assess whether a proposal will restrict competition.
- 3.64 If a proposal is likely to restrict competition, the RIS should examine its impact 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 or lead to the exit of some incumbent firms in a way that raises the prospect of collusion?
 - *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?
 - *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 to which the market in question supplies inputs)?

Box 7 – Competition assessment

If the answer to any of the questions below is 'yes', then this indicates that an option may restrict competition.

- Would the regulatory proposal restrict or reduce the number and range of businesses in an industry? Would it, 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?
 - change geographic barriers for businesses?
- Would the regulatory proposal restrict or reduce the ability of businesses to compete? Would it, 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?
 - significantly alter the competitiveness of some industry sectors?
- Would the regulatory proposal alter the incentives for business to compete? Would it, 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?
 - exempt an activity from general competition law?

3.6 Consultation

3.65 When developing the RIS, you need to outline the process and outcomes from consultation undertaken during the policy development process. Relevant information includes:

- the main views of the stakeholders
- areas of agreement as well as areas of difference
- information on intergovernmental consultation, and
- 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.

- 3.66 In general, any policy development process, including proposed new regulation or changes to regulation, will involve consultation with relevant stakeholders, including the main parties affected by the proposal: business, the not-for-profit sector, the community, regulators and other government agencies. Consultation helps to ensure that the full range of impacts is taken into account when assessing how best to solve a problem and the transparency it fosters helps to build trust in the policy process.
- 3.67 It is important that consultation be conducted with the attitude that the stakeholders' views will be listened to and taken seriously, rather than conducted as a 'box-ticking' exercise after the policy decision has effectively been made.
- 3.68 The following set of best practice consultation principles should be considered by all agencies when developing regulation:
- *Continuity* – Consultation should be continuous, and start 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 agencies.
 - *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. Agencies should be aware of the opportunities to consult jointly with other agencies to minimise the burden on stakeholders.
 - *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.
- 3.69 Appendix C provides guidance to help you incorporate these principles into your consultations.

3.7 Conclusion

- 3.70 In the conclusion you will ideally: provide a clear statement identifying the preferred option; indicate the costs and benefits of this option for the range of groups that are affected; and highlight any areas of uncertainty.
- 3.71 Your conclusion must be supported by the preceding analysis. This provision does not prevent you from recommending an option that does not have the highest estimated net benefit to the community. What it means, however, is that you cannot claim that such an option has the highest net benefit, and you will need to explain why you prefer this option.

3.8 Implementation and review

- 3.72 Having identified the preferred option to 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.
- 3.73 It is important that you 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 implement and enforce the proposed option, and the resource requirements and costs involved
 - actions regulated parties are required to take, such as maintaining extra information, completing forms, or proving experience, expertise or educational achievements
 - 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.
- 3.74 The RIS needs to outline how the regulation will be reviewed. This part should set out when the review is to be carried out, and information on how the review will be conducted; for example, if special data is required to be collected.

APPENDIX A. FIVE-YEARLY REVIEWS

- A1 Commonwealth regulation is required to be reviewed regularly. Regulation that has an impact on business or the not-for-profit sector, and is not minor or machinery in nature, is to be reviewed periodically unless it is subject to:
- the review provisions in the *Legislative Instruments Act 2003*, or
 - other statutory review provisions.
- A2 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. The review should take into account the nature of the regulation and its perceived performance.
- A3 Agencies will communicate their review schedule (all regulation subject to review in the upcoming year) and strategies in their Annual Regulatory Plan. Five-yearly reviews will also be published on the OBPR's online RIS register.

APPENDIX B. ANNUAL REGULATORY PLANS

- B1 Agencies responsible for regulatory changes that may have a significant impact on business 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.
- B2 These plans contain information about proposed regulatory activity, including a description of the issue, information about the consultation strategy and an expected timetable. (Guidelines for agencies on preparing and publishing regulatory plans are available at www.finance.gov.au/obpr). Contact the OBPR if you require assistance in preparing or updating your agency's plan.
- B3 Annual Regulatory Plans are published on the website of each agency and the OBPR will also publish the plans on its website. The plans are also linked to the business consultation website which aims to make consultation more effective.
- B4 It is up to individual agencies to manage the coordination and publication of Annual Regulatory Plans within their portfolio.

APPENDIX C. BEST PRACTICE CONSULTATION

- C1 RIS are required to demonstrate that consultation commensurate with the magnitude of the problem and the size of the potential impact of the proposal has been undertaken. This appendix contains more detail on the application of the whole-of-government consultation principles outlined in Chapter 2, and highlights the importance of developing a consultation strategy for regulatory proposals.
- C2 Agencies should be cognisant of the effort required from businesses and individuals to participate in consultation mechanisms. They should take advantage of the synergies involved in joint consultation with other agencies to minimise the burdens associated with consultation mechanisms. Australian Government agencies should also engage with agencies at other levels of government to benefit from shared experiences.
- C3 Online technology can increase engagement by citizens and public servants, and enhance collaboration in policy making. This will help government processes become more consultative, participatory and transparent. For example, subject to security and privacy requirements, submissions to public inquiries funded by the Australian Government can be posted online in a form that makes them easy to search, comment on and reuse.

C.1 Application of consultation principles

Continuity

- C4 Meaningful consultation with key stakeholders should be continuous and should start as early as possible. Consultation should continue through all stages of the regulatory cycle, including when detailed design features are being finalised. This will assist in identifying and understanding potential problems and in designing and implementing better regulation.
- C5 Agencies that have responsibility for providing policy advice to government should consult with the relevant regulators to ensure that regulations can be administered in a manner which is consistent with the objectives of the government. Regulators should consult with key stakeholders to understand the potential impacts of regulation on their operations.

Targeting

- C6 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.
- C7 Relevant individuals and groups may include:
- the general public
 - 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.

- C8 It may be appropriate to distinguish between stakeholders within these main groups where the impacts of options are likely to differ. For example, the views of businesses may vary depending on their size, nature of operations or location.
- C9 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.
- C10 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.
- C11 Relevant state, territory and local governments, and Australian Government agencies, should be consulted to ensure that regulatory policies across jurisdictions are consistent and complementary. In order to produce efficient regulation, it is necessary to avoid or minimise duplicating legislative requirements across agencies and government at all levels. This is particularly important where the regulatory processes arise from negotiations between different levels of government and/or involve overlapping responsibilities.

Timeliness

- C12 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 use of Annual Regulatory Plans is one way agencies can alert stakeholders to potential regulation.
- C13 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 it is necessary to consider a proposal promptly, some limitations on periods and timing of consultation may be unavoidable.

Accessibility

- C14 Consultation should ensure that stakeholders can readily contribute to policy development.
- C15 Agencies should inform stakeholders of proposed consultation via the most appropriate means; for example, press releases and advertisements in the media, including newsletters of industry or community associations, and the business consultation website (www.consultation.business.gov.au). This website will automatically notify businesses and government agencies of consultation processes in areas where they have registered an interest. The website and the Annual Regulatory Plan initiative are therefore cost-effective ways of alerting stakeholders to potential regulation.

- C16 Information provided to stakeholders should be easy to comprehend – it should be in an easily understandable format, use plain language and clarify the key issues, particularly where the proposed regulation addresses complex subject matter. 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, publishing relevant information or issues papers on the website of the agency sponsoring the proposal will make the process more accessible.
- C17 Consultation can take a variety of forms other than the written; for example, stakeholder or public meetings, working groups, focus groups, surveys or web forums such as blogs or wikis. The appropriateness of each approach will depend on the issues under consideration, the nature of the groups being consulted and the time available.

Transparency

- C18 Involving stakeholders from the earliest possible stage in the policy development process will promote transparent and comprehensive participation.
- C19 The objectives of the consultation process should be clear. To avoid creating unrealistic expectations, any aspects of the 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.
- C20 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 action or identifying particular areas where input would be valuable will encourage respondents to address these issues.
- C21 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. Agencies should provide for those stakeholders who want their contributions to remain confidential.
- C22 Information or issues papers – such as draft assessments of business compliance costs or draft RISs, green papers (policy options papers) or draft legislation – as well as submissions to government inquiries should, wherever possible and appropriate, be made available to stakeholders to enable them to make informed comments on proposals and proposed legislation. Ideally, relevant documentation should be posted online to enhance accessibility and opportunities for reuse. (Exposure drafts are discussed below.)
- C23 Agencies should also show stakeholders how they have taken consultation responses into consideration. The RIS is a good means of providing this information.

Consistency and flexibility

- C24 Consistent consultation procedures can make it easier for stakeholders to participate. Consistent processes can also permit better coordination of regulatory quality initiatives across a wide range of policy areas. In instances where ministers have made a commitment to a particular course of action, consultation can improve the design of the proposal and help ensure that it minimises the compliance burden on business and costs to the community.
- C25 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 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.
- C26 Consultation may not be appropriate for minor or technical amendments to regulation; for example, amendments that remedy errors or defects in existing regulation.
- C27 The OBPR can provide advice about the level of consultation appropriate to particular circumstances. It is important to consult the office 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

- C28 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.
- C29 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 options and affected the final decision. Agencies are strongly encouraged to publish consultation protocols on their websites.

C2. Consultation strategy

- c30 Good planning is essential to successful consultation. 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, consistent 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.

C31 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. Consultation plans can be published in your agency's Annual Regulatory Plan (see Appendix B).

C32 Consultation plans should cover the following points.

What is the objective of each consultation round?

C33 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 of each round of consultation should be clearly identified. For example, is the aim to gather new ideas (brain-storming), collect evidence and factual data, validate assumptions or clarify the possible impacts of a proposal on the wider community?

C34 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.

C35 Identifying the objectives of consultation will help determine who should be consulted, how and when.

Who will be consulted at each round?

C36 Agencies should ensure that the range of stakeholders affected by the proposal is consulted. 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 able to help in identifying target groups and those with technical knowledge or subject matter expertise.

C37 Ongoing consultation during policy development can be assisted by establishing web-based forums such as blogs or wikis. Depending on the nature of the information sought, such a forum could be openly available to the general public, or 'closed' to only include people meeting pre-determined requirements.

In what form will consultation occur at each round?

- C38 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. Increasingly, stakeholder groups are looking to participate through electronic means, such as email or web-based forums.
- C39 While written consultation is common, 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. There is the opportunity to use web-based mechanisms, such as blogs, as part of the consultation strategy.
- C40 Information, issues or green 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.

When will each round of consultation commence?

- C41 The timing of consultations is determined on a case-by-case basis, but 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 policy development, rather than as a one-off event.
- C42 An initial consultation could 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 how acceptable any preferred option is to stakeholders. However, the process should be balanced in order to avoid 'consultation fatigue'.
- C43 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?

- C44 A common complaint from business is the lack of time to provide feedback when asked for it. 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'. 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.

- C45 The length of each consultation round 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, a longer round may be appropriate where stakeholders are being asked to consider the whole proposal and there has been little previous consultation.
- C46 There is a broad range in the length of consultation rounds across agencies. However as a guide, six to twelve weeks seems appropriate for effective consultation depending on the significance of the proposals. (The United Kingdom Government's Code of Practice on Consultation, for example, stipulates a minimum of 12 weeks for written consultation at least once during the policy development process.)
- C47 Meaningful consultation with stakeholders throughout the policy development process should be documented in the RIS as a consultation statement. This 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.

C3. Exposure drafts

- C48 Consulting on and analysing the implementation options is an important part of policy development. Prior to finalisation, the details of complex regulations should be tested with relevant businesses. Releasing exposure drafts of complex regulations for significant matters is one approach agencies can use to allow businesses and other stakeholders to provide more detailed comments and advice on how a regulation will work in practice.

APPENDIX D. SMALL BUSINESS ADVISORY COMMITTEE

D1 The Australian Government established the Small Business Advisory Committee (SBAC) to further enhance the regulatory analysis process and the development of quality regulation. The role of the SBAC is to assist Australian Government agencies to determine the impacts of policy proposals on small business. The SBAC will provide agencies with greater knowledge and expertise across a wide range of business operations and industry sectors.

D.1 Selection of Regulation Impact Statements for review

D2 The SBAC's role is limited to RISs that are likely to have a significant impact on small business. If a regulatory proposal being developed by your agency is likely to be particularly burdensome for small business, you should contact the SBAC Secretariat at an early stage.

D3 When the OBPR determines that a RIS is required, the SBAC Secretariat and the relevant agency will decide whether a proposed RIS would benefit from being referred to the SBAC, taking into account the availability of committee members as well as timing issues.

D4 The SBAC Secretariat is located in the Industry and Small Business Policy Division of the Department of Innovation, Industry, Science and Research, and can be contacted via email at: SBACsecretariat@innovation.gov.au.

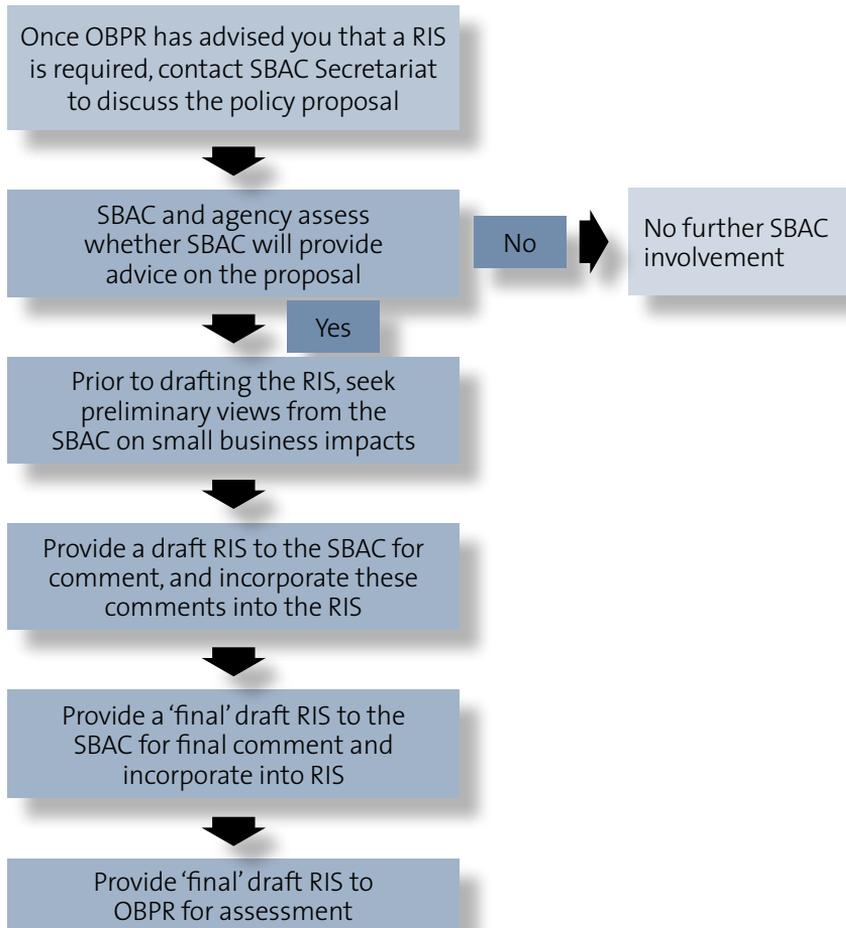
D.2 Role of the Small Business Advisory Committee

D5 If your RIS would benefit from advice from the SBAC, the Secretariat can allocate the policy proposal to the committee member with the experience and skill set most relevant to the proposal in question. The SBAC process is described in Figure 2.

D6 The role of the SBAC is not to formally assess the adequacy of the RIS, but to provide advice on the analysis in the RIS from a small business perspective. In reviewing the RIS, the SBAC will confine its consideration to whether the full range of possible regulatory impacts on small business has been considered.

D7 At each stage, the SBAC will produce a written report, including any suggestions for the analysis in the RIS; these reports will not be made public. The SBAC may recommend that you consider certain factors not already addressed, or that you include additional information on an issue raised.

Figure 2 – The SBAC process



APPENDIX E. COST-BENEFIT ANALYSIS

- E1 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.
- E2 The goal of CBA is to provide the final decision maker with as much information about a regulatory proposal as is relevant in informing the decision. It provides an objective framework for weighing up different impacts and impacts which occur in different time periods. This objectivity is supported by converting all impacts into present value dollar terms. However, even when full quantification of impacts is not possible, CBA can still be useful in providing a clear decision making framework.
- E3 In principle, CBA measures the efficiency or resource allocation effects of a regulatory change. It calculates 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.
- E4 CBA is useful because it:
- provides decision makers with quantitative and qualitative 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 on a single group within the community
 - assesses 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 identify cost-effective solutions to problems by identifying and measuring all costs.
- E5 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 analysts to more closely examine these factors.
- E6 This appendix provides an introduction to issues related to CBA for regulatory proposals. You can refer to a comprehensive guide to CBA, such as the Australian Government's *Handbook of Cost-Benefit Analysis* (Australian Government 2006) for more detail and guidance.

- E7 Most CBA guides concentrate on infrastructure projects where the costs and benefits are relatively straightforward to measure. Here, the focus is on issues specific to the CBA of regulatory proposals, where the impacts are more difficult to quantify. This Handbook also provides guidance on issues such as discounting to save duplication of effort each time a CBA is done and to promote consistency within government.
- E8 Topics covered include: an introduction to the steps undertaken in preparing a CBA (as set out in Box E.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 E.1 – Steps in preparing a full cost-benefit analysis

1. Specify the set of options
2. Decide whose costs and benefits count
3. Identify 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 option
8. Perform sensitivity analysis
9. Conclusion

Source: Adapted from Boardman et al. 2006

- E9 More information and assistance on preparing CBAs can be obtained from the OBPR website (www.finance.gov.au/obpr), or by contacting the OBPR.

E.1 The major steps in a cost-benefit analysis

- E10 Conducting a well-executed CBA requires you to follow a logical sequence that matches the steps involved in a Regulation Impact Statement. This section provides an overview of the nine basic steps.

1. Specify the set of options

- E11 You need to specify the set of options to solve a problem. One of the alternatives should always be to ‘maintain current arrangements’, providing the base case from which the incremental costs and benefits of each alternative can be determined and not ruling out that ‘doing nothing’ may be the best option available. Only costs and benefits which would not have been incurred in this base case should be included in the CBA.

2. Decide whose costs and benefits count

- E12 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. Identify the impacts and select measurement indicators

- E13 You should identify the full range of impacts of the proposals. Identifying the costs and benefits of a regulatory change involves comparing outcomes with the proposed change to outcomes without the change. As discussed above, it is important to identify the incremental costs and benefits for each option relative to the base case of what would happen with current arrangements.
- E14 Where relevant, the base case option should be forward-looking, recognising that the world in which the regulation will be implemented may differ from the current situation (key variables may change in the future, meaning that current or historical parameters may not be the most relevant benchmark). Importantly, the 'do nothing' option does not assume that no change will occur over time in the absence of regulation or a continuation of current regulation, and this should be recognised when identifying impacts.
- E15 All the effects of a proposal which are considered desirable by those affected are benefits – all undesirable effects are costs. CBA requires you to identify explicitly the ways in which the proposal makes individuals better or worse off.
- E16 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 a reduced number of accidents. The benefit from accidents avoided could be valued in dollars in step five.

4. Predict the impacts over the life of the regulatory proposal

- E17 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, exercise caution when adopting an evaluation period longer than, say, 20 years (although some environmental regulation may have a longer time horizon).
- E18 Predicting future impacts is difficult. There will always be some uncertainty surrounding the outcome of a regulatory proposal. Conducting an assessment of uncertainties should be a standard component of the evaluation of any major proposal. This means you would assess expected values and variability of cost and benefit flows, as well as taking downside risks into account.

- E19 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. You need to 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, your CBA should not just assume that the net benefits for one year will be repeated every year.
- E20 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 you explicitly consider and justify the assumptions underlying the forecasts, it improves implementation planning and identifies where more effort should be made to improve the analysis. It is a first step towards dealing with the uncertainties the regulatory proposal may create.

5. Monetise (place dollar values on) impacts

- E21 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.
- E22 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 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 E.3.
- E23 Dollar values can be estimated from observed behaviour. You 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 will likely be higher).

- E24 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. Environmental goods or safety provisions are typical examples of goods which are difficult to place dollar values on as they are typically not traded in markets. There are various methods for estimating non-market values of goods and accounting for uncertainty in CBAs. These are outlined below.
- E25 Other impacts may be very difficult to quantify in dollar terms. This does not invalidate the CBA approach and a detailed qualitative analysis should be incorporated in place of dollar values. Your qualitative analysis should be supported by as much evidence and data as possible to increase the transparency of the report and to assist the decision maker in choosing between alternative options.

6. Discount future costs and benefits to obtain present values

Why discount?

- E26 The need to discount future cash flows can be viewed from two main perspectives, both of which focus on the opportunity cost of the cash flows implied by the regulation. The first perspective is the general observation that individuals prefer a dollar today to a dollar in the future. This is most obvious in the fact that banks need to pay interest on deposits to entice individuals to forgo current spending. This general preference for current consumption is known as the 'rate of time preference' and relates to all economic benefits (and costs) not just those that are financial in nature.
- E27 Since individuals are not indifferent between cash flows from different periods, these flows cannot be directly compared. For monetised flows to be directly comparable in a CBA, those costs or benefits incurred in the future need to be discounted back to current dollar terms. This reflects society's preferences, which place greater weight on consumption occurring closer to the present.
- E28 Flows of costs and benefits resulting from a regulation also have an opportunity cost from an investment perspective. When regulations impose costs on individuals or businesses, these costs will need to be funded in some way. This funding imposes costs on the impacted party, either through the interest attracted through borrowing the money, or the returns foregone had the funds been used for other purposes.
- E29 The regulation will therefore only be beneficial when it provides a return in excess of the cost to society of deferring consumption, or of the return which could have been earned on the best alternative use of the funds. By applying a discount rate to future cash flows, the required rate of return is explicitly taken into account in the net present value calculation.

- E30 Either approach demonstrates that the need to discount future cash flows can be viewed in terms of the opportunity cost of the cash flows, whether this is the cost of delaying consumption or the alternative investment opportunities foregone. Since most of the costs and benefits of regulatory proposals are spread out over time, and their value depends on when they are received, discounting is crucial to CBA.
- E31 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 E.2 provides an example of how to calculate net present values. *The Handbook of Cost-Benefit Analysis* (Australian Government 2006) provides more guidance.⁶

Accounting for inflation

- E32 Inflation is another 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. Analysts conducting a CBA have the choice of whether to include future cash flows in terms of their actual monetary value at the future date (the 'nominal' value) or in terms of their current dollar value (the 'real' value). However, since all cash flows need to be converted to current dollar terms to be comparable in a CBA, it is usually simplest to adopt the latter approach.

The discount rate for regulatory interventions

- E33 CBA measures the value people place on various outcomes, preferably using their willingness to pay as revealed by their market behaviour. Consequently, the preferred approach is to base the discount rate on market based 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.
- E34 There is uncertainty about the appropriate discount rate to use for regulatory proposals. It is uncertain what the alternative uses for capital used by a proposal would have been, and what the capital would have produced in those uses.
- E35 The OBPR requires an annual real discount rate of 7 per cent.⁷ As with any uncertain variable, sensitivity analysis should be conducted – see below for more information on sensitivity testing. In addition to the 7 per cent 'central' discount rate, the net present values should also be calculated with real discount rates of 3 and 10 per cent. If the sign of the net present value changes, the sensitivity analysis reveals that the choice of discount rate is important. This information should be highlighted in the summary of the CBA as it is an important caveat for the analysis.

⁶ See chapter 4, pp. 49–62.

⁷ This is consistent with the United States Office of Management and Budget (2003), Perkins (1994), and New South Wales Treasury (1997), but below that recommended by Harrison (2010). Consistent with Harrison (2010), the OBPR will also accept analyses that use a central real discount rate of 8 per cent, with sensitivity analysis at 3 and 10 per cent.

Box E.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:

$$\sum_{t=0}^T \text{NPV} = (B_t - C_t) / (1+r)^t$$

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.

	<u>Costs</u>	<u>Benefits</u>	<u>Annual net benefit</u>	<u>Net present value</u>	
	(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

7. Compute the net present value for each option

E36 The net present value (NPV) of an option equals the present value of benefits minus the present value of costs:

$$\text{NPV} = \text{PV}(\text{B}) - \text{PV}(\text{C})$$

E37 If the NPV is positive, the proposal improves efficiency. If the NPV is negative, the proposal is inefficient. If all costs and benefits cannot be valued in dollars, you should outline why the non-monetised costs and benefits are large or small relative to the monetised impacts.

8. Perform sensitivity analysis

E38 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.

E39 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, you will need 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 you find that 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 by drawing key assumptions or parameter values from a probability distribution (see Boardman et al. 2006 for more details⁸). While this is a more robust approach to sensitivity analysis, care needs to be taken in adopting reasonable and justified assumptions about the probability distributions which have been assumed.

E40 If the sign of the net benefits does not change after considering the range of scenarios, there can be more confidence in the efficiency effects of the proposal.

9. Conclusion

- E41 You should summarise the results of the CBA. Given NPVs are predicted values, the sensitivity analysis might suggest that the alternative with the largest NPV is not necessarily the best alternative under all circumstances. For example, you 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').
- E42 Your conclusion 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.

E2. Dealing with costs and benefits that are difficult to value⁹

- E43 When a 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.¹⁰
- E44 It is, however, often difficult to identify and measure the effects of a regulatory proposal, especially when there are impacts on goods not traded in markets, such as pollution levels and access to scenic views.
- E45 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 monetary terms. Examples include environmental, social and cultural considerations, regional impacts, health and safety, publicity and national defence.

⁸ See chapter 7, pp. 181–4.

⁹ A more detailed explanation of these valuation methods and how they can be used in cost-benefit analysis is contained in a guidance note, available from the OBPR website.

¹⁰ See, for example, Commonwealth of Australia (2006), chapter 2, pp. 18–24.

- E46 It is important that you identify and describe all costs and benefits. You 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 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.
- E47 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, you should 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.
- E48 A wide range of tools have been developed to help you 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) or Commonwealth of Australia (2006) for more information.

Revealed preference techniques

- E49 Revealed preference techniques infer value from observed behaviour and market interactions. When individuals make purchases in markets, the price they pay reveals information about the value placed on that good. While this concept is useful for measuring the value of most markets, regulatory interventions typically deal with goods which are not directly traded in markets, or for which the market does not give a reliable signal as a result of one or more market failures. In these cases, estimating values to be included in a CBA will require that you consider non-market valuation techniques.
- E50 These techniques often require the use of market proxies to provide information on the value of a non-market good. When similar goods to the one being regulated are traded, their price will infer information about the value placed on the good in question. For example, information about the benefit of providing free public transport can be gleaned from travel patterns in cities where citizens pay for this service.
- E51 Regulations which aim to reduce the probability of a negative event occurring can be valued by analysing the expense to which individuals previously went to avoid the event. For example, health and safety regulations often need to estimate the value of a statistical life. This value is often estimated by analysing expenditure on smoke alarms, car airbags and other devices which are purchased by individuals to reduce the probability of death.

E52 In some cases, the 'price' paid for a good may not be a physical exchange of money but instead reflect the effort and expense that individuals have incurred to consume the good. This expense can be used to estimate the value of a good when no explicit market is present. For example, the values of visits to galleries or museums can be estimated by analysing the travel costs of visitors and the opportunity cost of their time.

Stated preference techniques

- E53 In some situations it may not be possible to use revealed preference techniques. These cases are generally when a good is not actively consumed or enjoyed by individuals, but its mere existence is still valued. In these cases it is still possible to elicit information on the willingness of individuals to pay for a good by simply asking them to state their preferences. Stated preference techniques rely on surveys to obtain information on how people value costs and benefits. These surveys are called contingent valuation surveys.
- E54 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.
- E55 Boardman et al. (2006) set out how to conduct contingent valuation surveys and outline some problems with the technique.¹¹
- E56 Choice modelling is another survey method which may be useful when the benefits from a proposal have many attributes and the options provide different combinations of those attributes. It is examined in *Cost-Benefit Analysis and the Environment: Recent Developments* (OECD 2006).¹²
- E57 To be a useful addition to a cost-benefit analysis, stated preference studies should aim to elicit willingness to pay estimates from well-informed individuals. For example, if a choice modelling study was trying to establish the community's willingness to pay for a regulation to reduce a particular environmental risk, it is important that participants in the study base their responses on accurate information about the nature of the environmental risks, rather than their uninformed perceptions of the risks. This underscores the importance of identifying, describing and, where possible, quantifying the likely impacts of a proposal.
- E58 As a general 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 (Boardman et al. 2006). 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 to be truthful. They bear little cost for inaccurate or ill-considered answers and may have an incentive to exaggerate.

¹¹ See chapter 14, pp. 369–402.

¹² See chapter 9, pp. 125–43.

Determining impact valuations from secondary sources

- E59 The methods discussed above provide a set of tools for the practical valuation of impacts, but may be difficult to implement. When you do not have the resources or expertise to conduct an original study, you may wish to 'plug in' values from previous studies. This process, called benefit transfer, has been used to estimate values such as the value of a statistical life or life-year, value of travel time savings and the cost of noise and air pollution.
- E60 While information from secondary sources can provide a quick, low-cost approach for obtaining desired monetary values, you should treat it cautiously and not use it 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.
- E61 It is advisable that you carefully scrutinise the accuracy and quality of the original study. When studies with technical weaknesses are used, you should discuss any biases or uncertainties that may arise as a result. Clearly, if a study has major weaknesses, it should not be used. Furthermore, information from secondary sources is most robust when several sources can be used to corroborate the assumptions or estimates made. In this area, as in others, the OBPR can provide assistance.

Dealing with costs and benefits that cannot be valued in dollar terms

- E62 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. You should report cost and benefit estimates within the following three categories:
- monetised
 - quantified, but not monetised, and
 - qualitative, but not quantified or monetised.
- E63 The challenge 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 and the nature of the inherent uncertainties in the size of the benefits.
- E64 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 Australian 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, depending on the benefits in question.

E65 If quantification is not possible, your analysis 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. Where possible, include relevant data to support the qualitative analysis. For example, information on the number of people impacted by the regulation, or the value added of the industry impacted may be useful to the final decision maker.

Cost-effectiveness analysis

E66 Cost-effectiveness analysis is a widely used alternative to CBA in circumstances where the most important impacts cannot be monetised. 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.

E67 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 a number of options 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).¹³

E3. Accounting for equity

E68 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.

E69 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 this decision.

E70 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 actions 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.

¹³ See Boardman et al. (2006), chapter 17, pp. 474–83.

- E71 A CBA clarifies the trade-offs when comparing alternative 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.

Accounting for future generations

- E72 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.
- E73 Rather than use an arbitrarily lower discount rate, the OBPR suggests 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.

E.4 Common cost-benefit analysis pitfalls

- E74 Some common pitfalls that arise, particularly in analysing regulatory proposals, include the following.¹⁴

Downplaying or ignoring non-financial social costs and benefits

- E75 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. You should take care to ensure that monetised impacts do not overshadow other important factors in the decision.

Double counting benefits

- E76 If the costs and benefits of a regulatory change have been estimated from the impact in a primary market, do not count them 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 of the benefits counted earlier).
- E77 More generally, impacts will often manifest in two ways: the real impact (for example, time savings or increased productivity), and the nominal impacts when the real impacts are reflected in markets. Either can be used to place dollar figures on the impacts, however, care should be taken that the analysis does not include both.

¹⁴ Commonwealth of Australia (2006) lists avoidable pitfalls in CBA in Appendix 1, pp. 118–19. This section draws on that discussion.

'Before/after' rather than 'with/without'

- E78 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.
- E79 This problem is especially prevalent when assessing the impact of regulations which are part of a suite of policies with the same aim (for example, there are several climate change actions aimed at reducing electricity use in buildings, and several regulations aimed at reducing the take up of cigarette smoking). In these cases it is important to analyse the incremental impact of the regulation being considered, recognising that even if no action is taken, the government's other actions may work towards the desired outcomes. That is, the 'without regulation' base case option should include the impacts of these complimentary interventions. Furthermore, you should consider whether the community would change its current behaviour in the absence of any government action.

Using the riskless rate of interest to discount net benefits that contain market risk

- E80 A riskless rate of interest should only be used to discount net benefits that are uncorrelated with market returns. The use of low 'social discount rates' is common in the CBA literature and often justified through one of the following arguments:
- the government can borrow at the bond rate, usually much lower than the market rate of interest, and therefore the rate of return required by the government is lower than the private sector
 - the government has a diversified portfolio of 'investments' and therefore faces no market risk, and
 - society should not discount the welfare of future generations.
- E81 However, these arguments are typically not pertinent for regulatory interventions. While it is true that the government can raise funds at the lower bond rate, it is the opportunity cost of these funds that is important (i.e. the alternative uses to which these funds could have been put), rather than the funding costs, in considering the social impact.
- E82 Further, the government is generally no better placed to diversify its asset holdings than individuals and unlike individual investors it does not usually invest funds with diversification in mind. Finally, you should not account for the welfare of future generations by adjusting the discount rate; this requires the relative value of different generations' welfare to be quantified and there is no accepted way of doing this. Rather, you should consider the impact of a proposal on future generations explicitly.

APPENDIX F. RISK ANALYSIS

- F1 Government regulation rarely deals with certainties. Regulation is often designed to reduce the likelihood of harmful or hazardous events occurring. Around half of all new regulations requiring RISs are risk-related. Examples include regulation to:
- reduce the incidence of workplace accidents
 - reduce public health hazards (e.g. food standards)
 - reduce risks from faulty consumer products (e.g. product safety standards)
 - reduce the risk of financial institution failure, and
 - reduce the risk of terrorist attacks.
- F2 Given the importance of risk-related regulation, the purpose of this guidance is to provide you with advice about how you can approach the evaluation of regulation aimed at managing risks in RISs. An effective approach to the management of risks requires that agencies develop a thorough understanding of the nature of the risks they are seeking to manage. This can be achieved by soundly applying risk analysis and economic evaluation principles.

F1. Defining risk and uncertainty

- F3 When talking about risk, a distinction is often made between the terms ‘risk’ and ‘uncertainty’. Risk usually refers to situations where the probability of a hazardous event occurring is reasonably well known and can be reasonably estimated. Uncertainty refers to a situation in which the probability of a hazardous event occurring cannot be reasonably (or reliably) estimated. In practice, this distinction is often difficult to draw because, while probabilities can generally be assigned to most events, there is seldom complete certainty about the size of all risks.
- F4 Risk analysis is an important part of the government’s best practice regulation requirements and, where relevant, must be incorporated into RISs. The purpose of risk analysis in a RIS is to shed light on sources of uncertainty about the possible impacts of proposed regulation on economic outcomes. Risk analysis should not be seen as a distinct step in the RIS process but should be considered throughout each step of the RIS process with particular emphasis on the problem and impact analysis sections.

F2. Problem definition

- F5 The problem section in the RIS describes the main issues that government action is designed to address. In the case of regulation aiming to manage risks or reduce harms, the problem section should identify what the risk is, and what will be the likely risk into the future in the absence of government action. This means that the problem section should contain relevant information on the size of the actual risk, its likelihood and nature (see discussion below). The problem section should also clearly identify who bears the risk and highlight how the risks are currently being addressed.

Actual versus subjective risks

- F6 The problem section of a RIS should focus on objective risks rather than ‘perceived’ risks. Perceptions about risk can be founded on bias and misinformation about the true magnitude and severity of risks (Viscusi et al. 1997). Individuals can often perceive a risk (or harm) to be much greater than it actually is – especially when there is a lack of information about the risk or strong perceptions about the size of the risk. To this end, in this section of the RIS you should focus on evidence about actual risks and seek to quantify the actual risk.
- F7 Perceptions about risk, however, should not be entirely overlooked. If there is inadequate information about a risk, or public misperception about a risk, this may call for government action to reduce the degree of misperception about the risk. For example, there is often considerable public misperception about many health risks (e.g. risks of sun exposure, risks associated with binge drinking). A possible response would be to inform the public through appropriate campaigns aimed at reducing the extent of misinformation.

Size of the risks

- F8 The size of a risk is generally characterised by the likelihood of an event occurring (i.e. the probability of the adverse event or harm occurring) and the size of the impact should the event occur.
- F9 Measuring risk can be a difficult task but can be achieved using reliable sources of information. Quantifying the magnitude of the risk is an important first step because it will inform the impact analysis (and cost-benefit analysis) at a later stage of the RIS process. Sources of information to identify the likelihood and severity of risks include:
- accident and incident data (e.g. fatality rates, incidence statistics)
 - coroner’s reports
 - actuarial estimates
 - medical research data (e.g. medical studies, epidemiological studies)
 - expert panel surveys, and
 - targeted surveys.
- F10 You can use information from these sources to inform stakeholders and decision makers about all the relevant facts so that they can make an informed decision. When using data from secondary sources as evidence, it is important to ensure that the estimates used appropriately characterise the risk associated with the problem being considered.
- F11 Where perceived risks are deemed important, the problem section should also inform stakeholders about general risk perceptions.

- F12 Some risks, however, will be very difficult to quantify; in these cases, sound qualitative assessments can be used to supplement quantitative analysis. The analyst should discuss the size of the risk by reference to the likelihood of the event occurring and the severity of its impact. This assessment may be supported by a discussion of the factors that contribute to the likelihood of the risk and by reference to the impacts of similar events occurring in Australia or overseas.

The nature of the risk

- F13 The problem section should describe the nature of the risk and the adverse outcomes that could eventuate in the absence of government action. Is it a risk that is straightforward to estimate (actuarial-type risks) or is the risk characterised by random events (e.g. flood, earthquake, terrorist attack)?
- F14 The evaluation and analysis should consider if there is a long delay between an adverse event and the consequences (latent risks). The adverse consequences associated with climate change, for example, will gradually occur over time. This means that the impacts of the associated consequences of climate change will most likely happen slowly. Some risks, for example the risk of terrorism, tornados, floods, and some disease outbreaks, will be characterised by random events that occur instantaneously and may require rapid response to deal with the impacts. Other risks, however, can be easily characterised because their occurrence is more easily observable (e.g. risk of damage to property, risks due to fires, risk of death due to car accidents).

Who bears the risk?

- F15 The problem sections should discuss which groups will bear the consequences if an adverse event occurs. The distribution of the risk may have important consequences for efficiency (some parties may be able to bear the risk at lower cost than other parties) and equity outcomes (it may be more socially acceptable for some parties to bear risk than others). The problem section should outline whether the distribution of risk is an important consideration.

F3. Impact analysis section

- F16 The impact analysis should be evidenced-based and comprehensive. This means you must identify all groups affected by the problem and its proposed solution, including those directly affected by the options and those indirectly affected. You should also assess the effects on the community as a whole in addition to this.

Assess the impact of the proposal on risk

- F17 You will need to appropriately examine the impact of each option identified to manage the risk. Your impact analysis should clearly spell out how each option will impact on the size and distribution of the risk. For each option being considered, this involves assessing the following questions:
- Will the proposal reduce the size of the risk (e.g. standards, information provision)?
 - Will the proposal remove the risk altogether (e.g. banning certain activities/ products)?
 - Will the proposal transfer risk from one party to another (e.g. mandatory insurance)?
- F18 A proposal may aim to reduce risks by imposing specific standards to improve product quality outcomes (e.g. food standards and product quality standards). In some instances the proposal might aim to mitigate risk by directly banning activities (e.g. banning cigarette smoking in vehicles or certain public spaces). Actions can also be proposed to transfer or redistribute risks (e.g. bank deposit guarantee schemes). You should analyse each option clearly in the light of its impact on risk reduction, transfer or elimination. The options should be examined in terms of their impacts on all those affected (e.g. consumers, producers, governments and regulators).

Quantify the risk

- F19 Quantify the risks as far as possible. This means that the impact analysis section should contain your detailed assessment of the size of the actual risk. The analysis should be informed based on existing sources of relevant evidence about risks or based on specific studies to uncover the size and magnitude of the risk. The analysis in the impact section will flow directly from the analysis given in the problem section of the RIS. To apply cost-benefit analysis (CBA), you will need to be informed about:
- the likelihood of the risk (an estimate of the actual risk), and
 - the impact of the proposal on probable future risk outcomes.
- F20 The latter will require that you make forecasts about how the proposed regulation or option will affect the future size and magnitude of the risk.

How are risks and hazards measured in practice?

- F21 Risks and hazards are often measured by the 'rate' or 'average number of occurrences' for an event of interest per 100,000 persons per period of time. The risk of death from drowning in Australia, for example, was estimated at 1.2 persons per 100,000 during the period 2004-05 (Table F.1).
- F22 Analysts should take care to ensure that all estimates used provide a reasonable assessment of the probability of the actual hazards being evaluated. Where available, consult data from different sources to compare and contrast estimates.

F23 Decision makers can use actual evidence on risks and hazards to assist them to prioritise their response. Understanding the level of risk is important for the impact assessment. To undertake a meaningful impact analysis it is important to understand and form expectations about how each option will reduce risks into the future.

What if risks cannot be quantified?

F24 When sound quantitative evidence is not available, discussion based on sound qualitative evidence can also be used to inform the RIS. However, you should attempt to quantify all risks as far as possible. When risks cannot be quantified, various approaches can be used to analyse the potential size and impact of risks. Qualitative tools for risk analysis include but are not limited to the following:

- using judgements based on expert panels
- risk categorisation matrix (prioritising or categorising to manage according to informed judgements about likelihood and severity), and
- comparative analysis (e.g. comparing the effectiveness of risk management approaches across different jurisdictions).

Table F.1 – Estimates of common risks ^a

Risk	Estimate
Drowning (all persons)	1.2
Drowning (persons in age group 0-4 years)	1.8
Poisoning (drugs)	3.7
Poisoning (other substances)	1.5
Smoke, fire and flames, heat and hot substances	0.8

^a All rates per 100,000 persons.

Source: Henley and Harrison (2009).

Assess the impact of each option by applying CBA

F25 Decisions about risk management strategies should be informed by consideration of the costs and benefits of regulation. Risk management strategies will impose costs and benefits on members of society and hence will support different efficiency and distributional outcomes. In practical CBA your aim is to quantify who will be impacted by the regulation and by how much. The key objective is to assess alternative risk management options in terms of their relative efficiency outcomes. This means quantifying all costs and benefits associated with a risk management strategy. You should also consider distributional impacts.

Consider potential unintended consequences of each option

- F26 Risk management policies can sometimes elicit adverse changes in the behaviour of economic agents (consumers, suppliers and other actors in the economy). In particular, agents may undertake riskier behaviour if they face a reduced likelihood of adverse consequences of that behaviour or if the consequences are borne by another party. This is known as the moral hazard problem.
- F27 Proposals aimed at guaranteeing bank deposits, for example, may elicit excessive risk-taking behaviour by financial institutions, which could result in large financial losses being borne by the broader community. When looking at changing work-related safety regulation, for example, it is important to consider the behavioural consequences of reallocating risks between employers and workers. Regulations that impose too stringent obligations on employers can potentially reduce the care taken by workers, hence resulting in increases in workplace accidents.
- F28 When evaluating the impact of government intervention it is important to consider the potential undesirable consequences on the behaviour of all stakeholders affected. This can be taken into account by applying sensitivity analysis within the CBA framework.

Dealing with uncertainty in risk analysis

- F29 Many risks are uncertain, this means that their size can be difficult to quantify in practice. On these occasions, you can take uncertainty into account by applying sensitivity analysis to the main assumptions. Various quantitative techniques could be useful where the probability distribution of risk is known. Where it is unknown, sensitivity analysis based on 'best case' and 'worst case' scenarios can be used. When the analysis of the risks and/or uncertainty is not possible, the RIS should include a qualitative discussion around sources of uncertainty of the risk, and how this might impact on the likely outcomes of the policy.

Tools for dealing with uncertainty

- F30 Uncertainty in cost-benefit analysis can be taken into account by using various quantitative tools and techniques. Boardman et al. (2006) provide a comprehensive account of different techniques that can be applied to deal with uncertainty in CBA. These include:

- *Sensitivity analysis* can be used when there is considerable uncertainty about the values of key variables used in cost-benefit analysis. When used in combination with probabilistic modelling, sensitivity analysis can provide a powerful tool to gain useful insights into the basis of 'worst' and 'best' case outcomes. Sensitivity analysis is often applied to assess the impact of changes in a key variable (single parameter) on the net benefit estimate.

Sensitivity analysis can also be used to check the overall robustness of the CBA results for changes in globally sensitive assumptions (e.g. cost and benefit estimates, and risk estimates).

- *Probabilistic modelling* can be applied to gain useful insights into the statistical distribution of uncertain variables used in CBA. Monte Carlo analysis can be used to evaluate the effects of changing various assumptions in the CBA and assessing the impact on net benefit estimates. This method allows analysts to estimate the degree of 'variation' associated with key CBA analysis parameters simultaneously and assess the impact on key CBA results.

F4. Implementation and review section

- F31 Given that many risks are uncertain (that is, the likelihood of them occurring is relatively unknown), and there is the potential for unintended consequences, it is important for the RIS to contain a detailed discussion of the policy implementation and review process.

How will the preferred option be implemented?

- F32 In this section you would provide an analysis of the key strategy to deliver the preferred option and the timings for when the preferred option is expected to be delivered. Your discussion should identify key risks and barriers that could prevent the effective delivery and implementation of the proposed strategy. These factors may include resource requirements, information gaps, administrative and compliance issues, and enforcement requirements. Strategies to overcome delivery barriers should also be identified.

How will the preferred option be reviewed?

- F33 The RIS should highlight the key details about how the expected option will be reviewed and assessed for effectiveness. This is particularly important where there is uncertainty about the risks involved because the optimal strategy may change as new information is gathered.
- F34 You should identify the most important information gaps and highlight how these gaps will be overcome; what systems or projects will be set up to allow the collection of data and the tracking of performance of the policy over time? Setting up (and describing) these processes early increases the chance of good quality information being collected once the policy is implemented and will help make the subsequent review more meaningful.

APPENDIX G. BUSINESS COST CALCULATOR

- G1 This appendix provides additional details about using the Business Cost Calculator (BCC).
- G2 The BCC is an IT-based tool designed to assist you to estimate the business compliance costs of various options. The BCC can be accessed from the OBPR website (www.finance.gov.au/obpr). If you have any queries about how to apply the BCC to your regulatory proposal, contact the OBPR.
- G3 The Australian Government requires that the compliance costs for business of proposed regulation be considered using the BCC or an approved equivalent tool. 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 Chapter 2.

G1. Scope of the Business Cost Calculator

- G4 The BCC has been developed to provide an automated and standard process for quantifying the compliance costs of regulation on business. It enables you to quantify these costs using an activity-based costing methodology.
- G5 The BCC is derived from the Standard Cost Model¹⁵, 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.
- G6 The BCC identifies eight categories of compliance tasks. The ninth category, ‘Other’, is used to capture costs not readily classifiable to one of the other eight (see Table G.1).

¹⁵ For more information see International SCM Network to Reduce Administrative Burdens (2005).

G2. Using the Business Cost Calculator

- G7 Once you have created an overview of the proposal, the BCC asks you to provide details about the compliance tasks associated with the 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 option.
- G8 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.

Table G.1 – Compliance task categories in the Business Cost Calculator

<i>Compliance tasks</i>	<i>Examples</i>
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.	

- G9 The BCC provides an executive summary called the BCC report and a number of other reports (by business, by size of 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

- G10 The information you will require for input into the BCC can come from a variety of sources. The BCC contains a number of links to help you search for data.
- G11 Where the detailed information required is not readily available, you may need 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, and
 - using Australian Bureau of Statistics data, especially on business populations.

Supporting information

- G12 The BCC is supported by a comprehensive online help facility; this can be downloaded as a separate document. There is also a worked example available for download from the BCC website.
- G13 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.

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