Chapter 7

Regulatory impact assessment: Incentive structures in the UK better regulation framework

by Ken Warwick and Faisal Naru[1]

This chapter presents practices and experiences in designing and implementing regulatory impact assessment in the United Kingdom. It focuses on the United Kingdom experience with regulatory reform and documents the history of the United Kingdom's better regulation agenda and then examines how recent initiatives affect the incentives in place to undertake good regulatory impact assessment (RIA). It also critically assesses the control mechanisms used in the United Kingdom to limit the amount of regulatory cost imposed on business. The chapter sets out how the chosen measure of business impact – the Equivalent Annual Net Direct Cost to Business – is calculated and assesses its merits as a target for policy. It also draws on United Kingdom experience to set out some principles for undertaking good regulatory impact analysis and briefly discusses some alternatives to cost-benefit analysis.

1. Ken Warwick is a consultant in economics and a member of the UK Regulatory Policy Committee, an independent scrutiny body. He is writing in a personal capacity and the views expressed in the paper do not necessarily represent those of the Regulatory Policy Committee. Faisal Naru is a Senior Economic Adviser at the OECD, Paris. The authors would like to thank Sue Bide, Ian Bishop, Filippo Cavassini, Wonhyuk Lim, Phil McCrea, and Hiroko Plant for helpful input and comments on earlier drafts.

Introduction

Since the late 1980s, successive governments in the United Kingdom have had policies in place to improve the quality of regulation and reduce its impact on business. Although an international trend, the United Kingdom was one of the first to introduce a systemic tool for improving the economic analysis of new regulatory interventions. In the late 1990s the requirement for conducting regulatory impact assessment was made compulsory by Prime Minister Tony Blair for any new regulatory proposal from any government department. This was followed by a number of transformative reviews and initiatives that have shaped the current regulatory management system. These reforms have changed the infrastructure and methodology around regulatory impact assessment (RIA) in ways designed to improve the incentives faced by policymakers and regulators.

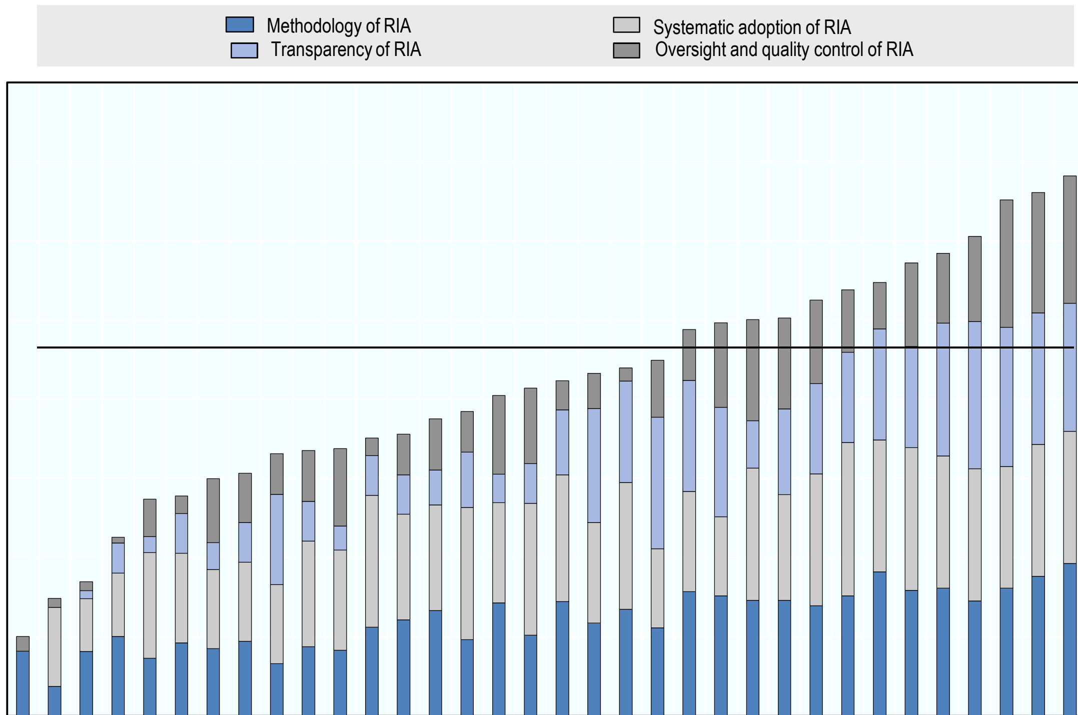
In any market economy, a system of regulation is essential to underpin a fair and competitive market, promote economic growth, support business and protect consumers, society and the environment. Regulation, however, imposes costs on business as they implement and demonstrate their compliance with the regulatory requirements of government. If unchecked, regulation can become more complex and cumbersome over time and the costs to the economy can be significant. Excessive regulation impedes innovation and creates unnecessary barriers to trade, investment and economic efficiency. Moreover, this tendency can be exacerbated if policy makers seek to deliver policy objectives through regulation rather than public spending at a time when public finances are under pressure.

This chapter does not consider in any detail the evidence around the contribution better regulation can make to enterprise, growth and employment (for a review, see Frontier Economics, 2012). Nor does it consider the evidence on how improved RIA affects policy. It is taken as axiomatic that better impact assessment makes for better policy and that better regulation is conducive to enterprise and growth. Instead we focus on the incentives in place to undertake proper Impact Assessment and to limit the amount of regulatory cost imposed on business. The purpose of the chapter is to focus on how RIA is implemented and the control mechanisms in place to make sure regulation is appropriate.

The justification for focusing on the United Kingdom is that there is evidence that the regulatory environment has improved in the United Kingdom in recent years and that the United Kingdom is lightly regulated by OECD standards. A survey of business perceptions, undertaken jointly by the National Audit Office with the Department for Business, Innovation and Skills (NAO and BIS, 2014), found that although 51% of businesses saw the level of regulation in the United Kingdom as an obstacle to business success, this was down from 62% in 2009. The latest survey published in August 2016 revealed a further slight fall to 49% in 2016 (BEIS, 2016).

In 2013, United Kingdom product market regulation was the second least restrictive among developed economies (Koske et al, 2015). A report commissioned by BIS (Frontier Economics, 2012) concluded that "the United Kingdom is a highly deregulated economy when compared to other OECD countries". The United Kingdom is also seen as a leader in the implementation of Regulatory Impact Assessment[1] and its system much studied and admired.[2] Figure 7.1 shows that the United Kingdom scores highly in the OECD composite indicators for the effectiveness of regulatory impact assessment.

Figure 7.1. **Composite indicator: Regulatory impact assessment for developing primary laws**



Note: The results apply exclusively to processes for developing primary laws initiated by the executive. The vertical axis represents the total aggregate score across the four separate categories of the composite indicators. The maximum score for each category is one, and the maximum aggregate score for the composite indicator is four. This figure excludes the United States where all primary laws are initiated by Congress. In the majority of countries, most primary laws are initiated by the executive, except for Mexico and Korea, where a higher share of primary laws are initiated by parliament/congress (respectively 90.6% and 84%).

Source: OECD (2014).

It is, therefore, instructive to examine more closely the United Kingdom system. If business and external observers believe that government policy on regulation is moving in the right direction, are there features of the institutional set up and methodology that help promote this? This chapter provides a critical analysis of "how" RIA is implemented in the United Kingdom and the institutional and methodological factors that contribute to its effectiveness. Some pointers are also given in passing to ways in which the system could be improved and to comparisons with other countries. The chapter summarises and critically assesses the current practices of RIA in the United Kingdom including:

- the policy or legal requirements/frameworks;
- the mechanisms for institutionalisation;
- methodologies applied;
- evaluation or impact of RIA; and
- the role of key stakeholders (e.g. business/citizens and their associations, parliaments, audit offices, productivity commission) in making RIA successful.

The structure of the chapter is as follows. It first considers the history of regulatory reform from the 1980s until around 2010. It then examines the current institutional infrastructure around RIAs in the United Kindgom system, and the hard and soft levers that are in operation. It then move on to consider some of the methodological questions that arise in a RIA system; in particular, the choice of metric for target/budget, what constitutes good practice in RIA methodology and the limitations of cost-benefit analysis.

Drawing on the analysis, the final part suggests preliminary policy findings regarding the design, implementation and management characteristics of RIA programmes that might help improve the efficiency and effectiveness of regulatory policy and governance. A final section offers some concluding observations.

History of regulatory reform in the United Kingdom

Before examining in detail the current United Kingdom RIA system, this section provides the contextual basis for how RIA was first introduced in the United Kingdom and how it evolved over time along with the better regulation agenda as a whole. It demonstrates the many iterations and reinventions of regulatory reform and the sustained efforts that are still under way today.

In the late 1980s a Deregulation Unit was established under the Thatcher Government in the Department for Trade and Industry (DTI). Its focus was solely on reducing the regulatory burdens on businesses. Departmental Deregulation Units were also established to "support ministers in driving forward the review of regulations to ensure abolition of those which are unnecessary and to minimise the burden on business of necessary regulation.[3]

The DTI Deregulation Unit first introduced an analysis of the impacts of new proposals but was focused narrowly on the administrative costs of regulation. In addition there was no analysis of benefits. Analysis was conducted by the unit in DTI or Departmental Deregulation Units and efforts were made across government departments to utilise the analysis to prevent unnecessary administrative costs on businesses from new regulations.

The DTI unit was moved to the Cabinet Office in 1996 where there began a marked shift from reducing existing burdens to focusing efforts towards the overall quality of new regulations and in particular a greater focus on assessing the impacts of new regulations. A whole-of-government approach was an important part of this change.

In 1997, the central deregulation unit was transformed into the Regulatory Impact Unit (RIU) and in August 1998 Regulatory Impact Assessments were introduced under the Blair Government. The requirement was mandatory and was applicable to any new law, regulation or policy that would have an impact on businesses, charities or the voluntary sector. The RIA framework introduced the requirement to assess both the costs and the benefits of regulatory proposals.

The RIU's remit was to reduce the existing regulatory burdens (*stock*) and enhance the regulatory quality of new regulatory proposals (*flow)* affecting both the private and public sector. The unit also had a dedicated team for the European Union that not only addressed regulatory proposals from Brussels but also supported the "regulatory reform" agenda across Europe. The RIU also had a "regulatory innovation" directorate that began looking at new areas to improve the regulatory environment such as at the local government level. The number of staff in the RIU was around 50, mainly civil servants

with a few secondees from the private sector and some from similar oversight units in other countries.

The Better Regulation Task Force (BRTF), which was an independent advisory group, was also established in 1997. The members were appointed by the Minister for the Cabinet Office. Appointments were unpaid and for two-year renewable terms. Members were from a variety of backgrounds, including large and small businesses, citizen and consumer groups, unions, the public sector, not-for-profit and voluntary groups and those responsible for enforcing regulations.

One of the first outcomes from the BRTF was to develop the United Kingdom's five principles of good regulations[4] which were:

- Proportionality – Regulators should only intervene where necessary and should choose the delivery option which will achieve the desired results while minimising costs and burdens.
- Accountability – Regulators need to account for their decisions, including the chosen option for delivery and its subsequent impact.
- Consistency – All types of intervention from regulations to voluntary agreements need to be joined up and implemented to a consistent standard.
- Transparency – Regulators need to ensure that those being regulated understand the process and are invited to suggest alternative delivery options, where appropriate.
- Targeting – All types of intervention from regulations to voluntary agreements need to be focused on the problem and avoid burdensome side effects.

The BRTF conducted studies on particular regulatory issues. These reviews were undertaken by sub-groups of the BRTF members and were the subject of consultation with key organisations and individuals, as well as with ministers and government departments. The BRTF stated that it worked "through consensus and all reports are endorsed by the full Task Force before being sent to the relevant ministers for their response." The Prime Minister asked all ministers to respond to Task Force reports within 60 working days of publication. The BRTF also responded to consultation exercises on regulatory proposals, RIAs and provided comments on live regulatory issues[5].

During this time Departmental Regulatory Impact Units (DRIUs) began to emerge in ministries as the first contact points for policy officials for regulatory quality. The Cabinet Office RIU provided coordination, guidance and advice to DRIUs in complying with the requirements for RIA and public consultation as well as working on the various public and private sector deregulatory projects with both the RIU and BRTF.

The RIU's European Team worked with other members of the United Kingdom Government and were active in the Mandelkern Group, whose report on a regulatory reform strategy for the EU[6] was the basis for the European Commission's June 2002 Action Plan on better regulation[7].

In January 2003, the better regulation agenda was further enhanced. In the Cabinet Office's Better Policy Making guide for RIA, Tony Blair said "I have charged the Cabinet Office to ensure departments deliver better regulation through full compliance with the RIA process. Where regulations or alternative measures are introduced….decisions should be informed by a full RIA…which also includes the wider economic, social and environmental impacts.[8]"

During 2003 to 2004 a number of new initiatives began and results were achieved. In particular it was in this period that rates of compliance for departments conducting RIAs for significant regulatory proposals increased from 66% to 97%. Subsequently the United Kingdom's focus for RIA changed from a focus on administrative costs towards increasing quality across the whole of government. This included streamlining the types of specific impact test that were required by policy makers (e.g. local impact, environmental impact, gender and race equality impact, etc.) into the three stated by the Prime Minister, i.e. wider economic social and environmental impacts.

The Panel for Regulatory Accountability was also established at this time, chaired by the Prime Minister with members of the panel including the Chancellor of the Exchequer and the Chair of the Task Force. This was a new Cabinet Committee which met regularly to discuss regulatory issues with ministers and in particular their department's "regulatory performance".

The attention to regulatory quality during this time was extended to Cabinet meetings for major proposals and the RIU coordinated briefings on regulatory issues with the Prime Minister's No.10 Downing Street office, HM Treasury and the Cabinet Office's Economic and Domestic Secretariat. This ultimately placed RIA at the centre of the policy making and decision making processes of government.

In 2005 the RIU was transformed into the Better Regulation Executive (BRE) now with almost 100 staff. Departments had to submit their RIAs for approval by the BRE as directed by the Prime Minister. Ministerial and Senior Civil Servant champions for Better Regulation were appointed in departments and given responsibility for spreading good regulatory practices across their departments.

In 2005 there was also the publication of two influential reports: i) the Hampton Review[9] and ii) "Regulation - Less is More" by the BRTF[10]. The Hampton review examined regulatory delivery mainly enforcement and inspections but also regulators. The BRTF report recommended that the United Kingdom undertake an administrative burden reduction programme, implement a system of post-implementation reviews, start a rolling programme of simplification, and introduce a one-in-one-out system as well as giving future consideration to automatic sunsetting and the introduction of regulatory budgets.

The Government accepted the reports and the BRE was tasked to implement the recommendations. The BRTF was replaced by a permanent body, the Better Regulation Commission (BRC), on 1 January 2006 to provide advice and oversight of the implementation of the "Less is More" recommendations and give further support to better regulation in the United Kingdom.

In July 2007, the BRE moved from the Cabinet Office to become part of the Department for Business, Enterprise and Regulatory Reform (BERR), and then its successor, the Department for Business, Innovation and Skills (BIS) which is now the Department for Business, Energy and Industry Strategy (BEIS)[11].

In 2008, the BRC was closed and work was being fully implemented by the BRE. At the same time the Risk and Regulation Advisory Council was established by the Prime Minister until 2009. The Risk and Regulation Advisory Council was an independent advisory group which aimed to improve the understanding of public risk, and how best to respond to it, in making and implementing policy.

By 2010, many of the BRTF and Hampton review recommendations had been implemented including a baseline measurement of burdens, simplification plans by departments and the establishment of the Local Better Regulation Office with a particular focus on local regulatory delivery. The recommendation on regulatory budgets was not implemented but laid the foundation for the introduction of a "one-in, one-out" system.

The RIA system evolved during this time with the various activities of the BRE that converged into a more focussed regulatory management system that linked the compliance costs in the simplification plans and introduced greater economic consideration and methodologies in the RIA process. The legal underpinning of better regulation was reviewed and an independent review body for RIA was considered.

From 2010 onwards, a number of initiatives followed including changing the Local Better Regulation Office first to the Better Regulation Delivery Office and then to Regulatory Delivery. A "Red Tape Challenge" followed the simplification plans and a "one-in-one-out" system was first superseded by a "one-in-two-out" and then "one-in-three-out" system.

In particular, the United Kingdom's Regulatory Policy Committee (RPC) was set up in 2009 and in 2012 it became an independent advisory non-departmental public body. The RPC remains the main oversight body for RIA in the United Kingdom system and the remainder of this chapter examines in detail the development of the regulatory reform agenda in the United Kingdom since 2010, the current RIA system, and the role of the RPC.

Infrastructure around RIAs in the United Kingdom system

In this section we examine specific features of the institutional infrastructure around RIAs in the United Kingdom system, and the hard and soft levers that are in operation. Some of the key features of the United Kingdom system that help promote good quality impact assessment are:

- legislative basis for the better regulation framework;
- role of independent scrutiny;
- leverage of a budget constraint or target;
- buy in from stakeholders;
- importance of codified methodology.

Legislative basis

The legal framework for the current system of regulatory control in the United Kingdom is set out in an Act of Parliament, namely the Small Business, Enterprise and Employment (SBEE) Act 2015.[12] The SBEE Act received Royal Assent in March 2015. The Act contained many provisions designed to promote enterprise, innovation and growth but the main measure of interest for regulatory reform related to the establishment of a Business Impact Target, backed up by a series of measures to ensure transparency and independent scrutiny. The Act entrenches in law, for the first time in the United Kingdom, the setting of a deregulation target and the transparent reporting of new regulatory burdens on business. In so doing, the Government's intention was to assure business and Parliament that its assessment of regulatory performance is robust and

economically sound and that future governments will continue to set a limit on regulatory burdens.

Among the specific features of the regulatory scrutiny process legislated for in the SBEE Act were the following requirements:

- Publication of an overall target for the economic impact of new legislation for each Parliamentary term, as well as a mid-point milestone target.
- Publication of annual reports and a final report on performance against the agreed target.
- An assessment of the actions taken by departments to mitigate the impacts of new regulations on small businesses as part of the annual and final reports.
- An assessment of any instances of 'gold plating'[13] of EU legislation as part of the annual and final reports.
- Strengthening the accountability of individual departments for their regulatory performance by including detail on departmental performance in the annual report.
- Independent scrutiny of the economic impact estimates used in the government's assessment of their performance against the target, in order to give confidence to Parliament and others that reporting is based on figures that are accurate and robust.

The arrangements set out in the SBEE Act build on, and consolidate with a clear legislative basis, mechanisms and structures that have evolved over the last five years or so. Independent scrutiny has been in place since the creation of the Regulatory Policy Committee in November 2009, later formalised in April 2012 as an independent non-departmental public body (NDPB). Transparent accounting for regulatory cost and a metric for calculating and expressing the business impact have been in place since 2010. At the start of the 2010-15 Parliament, the then Prime Minister made a commitment that the Government would be the first in modern history to end a parliamentary term with the burden of regulation lower than at the start. This was later supplemented by a "one-in, one-out rule", under which departments were expected to find savings in regulatory cost to business for each extra pound of regulatory cost introduced. In 2013 the "one-in, two-out" rule replaced one-in, one-out, and other reforms introduced including a requirement for *ex post* evaluation of regulation through Post Implementation Reviews (PIRs).

The SBEE Act represents a further evolution of these elements of the regulatory control system, with a legislative basis underpinning greater transparency, more explicit reporting requirements, independent regulatory scrutiny and a target for the control of regulatory cost. The first reports under the new system were published in the summer of 2016, together with a critical analysis by the NAO on the first year of the system (BIS, 2016; RPC 2016; NAO, 2016).

In addition to the legislative basis provided by the SBEE Act, the institutional infrastructure supporting the regulatory control system includes a number of different bodies each with different roles, as shown in Table 7.1 below (Annex A has more detail on the resources devoted to better regulation):

- The Better Regulation Executive, reporting jointly to the Business Department and the centre of Government, is responsible for developing and implementing a framework for achieving the target.
- Policy teams in government departments prepare Regulatory Impact Assessments, assess the cost to business and seek to reduce it through better regulation or deregulation. RIAs are signed off by the senior departmental analyst and the responsible Government Minister, who is required to confirm that he has read the RIA and that he is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.
- Better Regulation Units in government departments champion better regulation principles and act as a contact point between the BRE and departments.
- The Reducing Regulation Cabinet sub-Committee (RRC)14 provides strategic oversight of the government's regulatory framework and provides the mechanism for clearance and scrutiny of any measure that regulates or deregulates business and requires collective agreement.
- The Regulatory Policy Committee (RPC) provides independent scrutiny of RIAs verifies the cost to business and publishes annual reports on departmental and Government performance. Unless a measure qualifies for the 'fast track' (see below), an Impact Assessment cleared by the RPC needs to be submitted to the RRC before it can be given clearance. Only in exceptional circumstance may a department seek RRC clearance without a 'fit for purpose' rating from the RPC. This provision helps gives the RPC leverage in its scrutiny function

Table 7.1. **Key government bodies involved in achieving the Business Impact Target**

Government body	Role
Better Regulation Executive (BRE)	Unit reporting to BEIS and Cabinet Office ministers that leads deregulation across government
Departmental and regulator policy teams	Expected to make regulatory decisions to cut the costs of regulation for businesses
Better Regulation Unit (BRU)	Individual departmental teams responsible for promoting principles of better regulation and advising departmental policymakers
Regulatory Policy Committee (RPC)	Independent verification body responsible for providing external challenge of the evidence and analysis presented in impact assessments
Reducing Regulation Cabinet sub-Committee (RRC)	A cabinet sub-committee established to take strategic oversight of the government's regulatory framework

Source: National Audit Office (2016), "The Business Impact Target: cutting the cost of regulation", NAO, London; based on BIS (2015), "Better Regulation Framework Manual: Practical Guidance for UK Government Officials", Department for Business, Innovation and Skills, London.

In addition, the National Audit Office and Parliament also have an oversight role in the better regulation framework. The NAO conducts regular value-for-money reviews of the better regulation programme. The NAO makes recommendations on how to achieve better value for money for the resources used and, without questioning Government policy objectives, on how to strengthen regulation in order to help markets work more effectively, for example encouraging greater use of post-implementation reviews and giving a critical assessment of progress against the Business Impact Target. NAO value for money reports are presented to Parliament, mostly for consideration by the Public

Accounts Committee (PAC) in hearings at which members take evidence from the senior officials of organisations under scrutiny. The PAC then publishes its own report and recommendations, to which the Government must respond. The PAC has recently published the findings from its own inquiry into better regulation in response to the NAO report (House of Commons, 2016).

In addition to the PAC, which has a cross-cutting role, there are Parliamentary Select Committees covering the business of each government department and they have access to and use RIAs and RPC Opinions in their scrutiny of specific policy initiatives. Impact Assessments and RPC Opinions are also cited in consultation documents which are regularly reviewed by Select Committees and in briefing papers prepared by the House of Commons library researchers to brief MPs. Recent examples include the consultation on the relationship between pub companies and their tenants (BIS, 2013), cited by the BIS Select Committee (House of Commons, 2013) and a briefing paper on the National Living Wage (McGuiness and O'Neill, 2016). The BIS Select Committee was replaced by the Economic Affairs and Industrial Strategy Committee, shadowing a new Cabinet Committee on the Economy and Industrial Strategy set up by the Prime Minister in August 2016.[15]

Other Parliamentary Committees that review RIAs and RPC Opinions include the Regulatory Reform Committee, the Joint Committee on Statutory Instruments and the Secondary Legislation Scrutiny Committee. Box 7.1 briefly describes their roles.

Box 7.1. **Parliamentary Committees and their roles**

Commons Select Committees: There is a Commons Select Committee for each government department, examining three aspects: spending, policies and administration. They decide on lines of inquiry and gather oral and written evidence. Findings are reported to the Commons, printed, and published on the Parliament website. The government then usually has 60 days to reply to the committee's recommendations.

Lords Select Committees: While House of Commons Select Committees are largely concerned with examining the work of government departments, committees in the House of Lords concentrate on six main areas: Europe, science, economics, communications, the United Kingdom constitution and international relations.

Public Accounts Committee**:** The PAC is a cross-cutting Commons committee that scrutinises the value for money – economy, efficiency and effectiveness – of public spending and generally holds the government and its civil servants to account for the delivery of public services.

Regulatory Reform Committee**:** The Regulatory Reform Committee was appointed to consider and report to the House on draft Legislative Reform Orders under the Legislative and Regulatory Reform Act 2006. It has not issued a report since 2009-10, but the current chairman has plans to revive it. There is a parallel committee in the House of Lords.

Joint Committee on Statutory Instruments**:** Re-established after the 2015 election, the JCSI is appointed to consider statutory instruments (SIs) made in exercise of powers granted by Act of Parliament. It meets most weeks that Parliament is in session and issues weekly reports to both Houses on SIs. It does not comment on policy.

Select Committee on Statutory Instruments: SCSI carries out the same duties as the Joint Committee on Statutory Instruments in respect of those instruments laid before and subject to proceedings in the House of Commons only.

Box 7.1. **Parliamentary Committees and their roles** (*cont.*)

***Secondary Legislation Scrutiny Committee*:** The SLSC is a House of Lords Committee that examines the policy merits of regulations and other types of secondary legislation that are subject to parliamentary procedure. Through its reports, the Committee draws to the "special attention of the House" SIs laid in the previous week which it considers may be interesting, flawed or inadequately explained by the Government.

Source: www.parliament.uk/about/how/committees/select/.

Independent scrutiny

Recognising the importance of independent scrutiny to better policymaking, several countries have established an Independent Scrutiny Unit to validate RIAs, improve the quality of regulatory impact assessment, and increase the credibility of the RIA as part of the policy making process (Box 7.2).

In the United Kingdom, the Regulatory Policy Committee (RPC) is the independent advisory body providing external, real time scrutiny on the quality of evidence and analysis for all regulatory proposals, whether domestic, EU or international in origin, that have an impact on business and voluntary and community bodies.[16] For all such measures, the RPC confirms or rejects either:

- the government's estimated costs and benefits to business of the final policy proposal; or
- its assessment that the proposal will not count towards the government's deregulatory target and is likely to have a limited impact.

For legislative measures with a significant impact on business, the RPC also assesses the quality of the evidence supporting the proposal before consultation.

Box 7.2. **Independent Scrutiny in Europe**

A number of other EU member states have introduced a better regulation agenda similar in approach to the United Kingdom. Together with the RPC, four other independent scrutiny bodies from the Netherlands, Germany, Sweden and the Czech Republic set up a collaboration under the banner of RegWatchEurope. RegWatchEurope exists to enable the independent bodies of these member states to speak with one voice to influence the EU institutions on the development of Europe's better regulation agenda. RegWatchEurope draws on the network's expert knowledge to improve the quality of RIAs in respective member states, emphasising the potential benefits of independent scrutiny at the European level in particular. The roles and powers of these bodies in scrutinising RIAs differ from country to country – see Annex B for a more detailed tabular comparison.

Other European countries are also establishing independent scrutiny bodies. Finland and Norway have recently established independent councils to review RIAs for their respective government's proposals and the two councils have joined RegWatchEurope. Iceland is also in the process of establishing an independent scrutiny body. In 2014, following RPC engagement with French authorities, the French government announced its intention to establish an independent scrutiny body. The RPC has also worked closely with the internal impact assessment body of Poland whose purpose is to improve the quality of RIAs in Poland. The RPC has also hosted a number of economists from overseas to provide direct experience of the United Kingdom's approach to impact analysis and scrutiny.

Box 7.2. **Independent Scrutiny in Europe** (*cont.*)

The Commission has also established the Regulatory Scrutiny Board, an independent group of officials and experts whose role is to check the quality of all impact assessments and major evaluations that inform EU decision-making. The Regulatory Scrutiny Board replaces the former Impact Assessment Board and has wider responsibilities. In principle, a positive opinion is needed from the board for an initiative accompanied by an impact assessment to be tabled for adoption by the Commission.

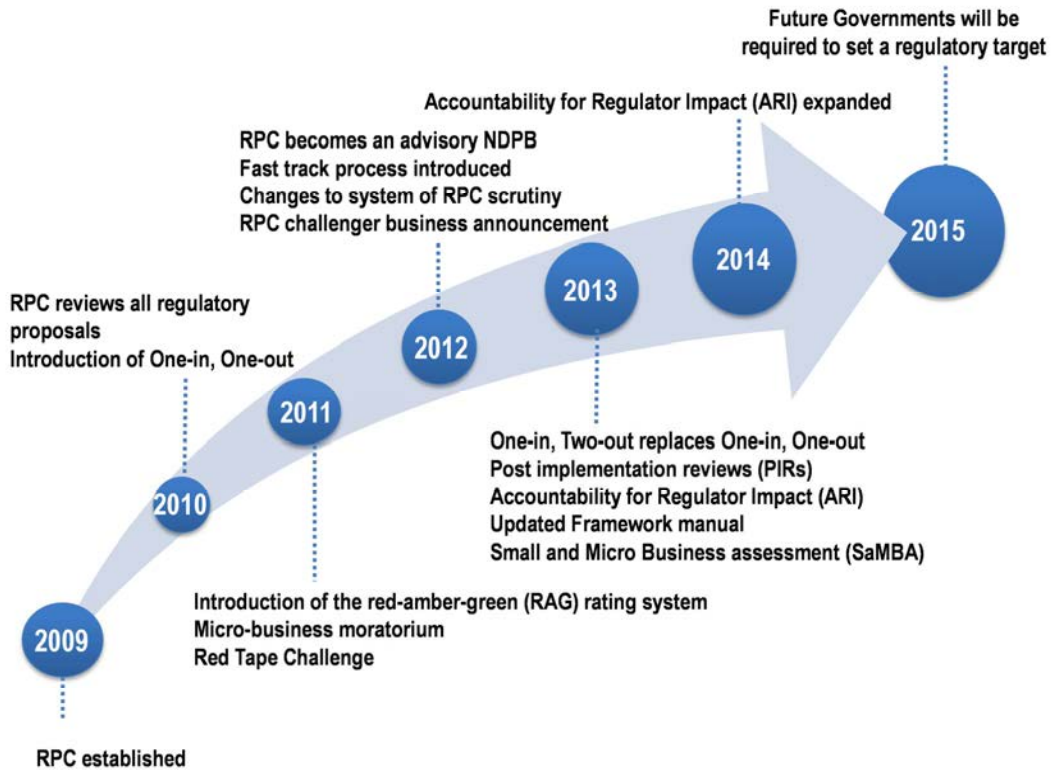
Source: Based on RPC (2015a), "Securing the evidence base for regulation: Regulatory Policy Committee scrutiny in the 2010 to 2015 Parliament", Regulatory Policy Committee, March; and RPC (2016b), Regulatory Policy Committee Corporate Reports 2015-16, July, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/538414/rpc_corporate_report_15-16_final.pdf.

The RPC's role in the regulatory control system has been evolving since its foundation in 2009. Its role in independent scrutiny of RIAs was confirmed when it was named in July 2015 as the Independent Verification Body, as defined in the SBEE Act. In this capacity, the RPC is charged with verifying the costs and savings of changes in law introduced by the Government and independent regulators[17] that affect business – large and small – and civil society organisations. The RPC will provide independent assurance on the Government's progress in meeting its commitment to cut £10 billion of regulatory cost over the course of the parliament. This complements the RPC's role as the independent quality assurance body scrutinising the evidence and analysis. The Committee is appointed by the responsible minister in the Business Department, following an open public process. It consists of eight members with business, academic and other experience, including two economists. Committee members are independent of government and work on a part-time basis, supported by a Secretariat of 15 civil servants, including policy officials and economists (Annex 7.A).

The RPC is very clear that it does not comment on policy, only on the quality of the impact assessment.[18] The Committee agrees and issues Opinions, which are generally published, on the quality of RIAs prepared by department. Since 2011, Opinions have featured a 'traffic light' rating and league tables of departmental performance in terms of Red, Green and Amber ratings[19] have been published in the Committee's annual report. Opinions are generally published at the same time as the RIA on which they comment, but if a department chooses to respond to a Red Opinion by revising the RIA, then the Opinion will not usually be published. It will of course be seen by the officials responsible for the policy and usually by the Minister, and departments generally respond by revising either the policy or the Impact Assessment until it comes up to the required standard and receives a Green opinion. It is only in the rare cases when a department proceeds with a measure without a Green Opinion that the RPC will publish a Red Opinion. This only happened 14 times out of just over 2000 Opinions issued during the 2010-15 Parliament (RPC (2015a: 12 and 22). For example, in July 2015, the RPC issued red-rated Opinions on three Impact Assessments covering a package of Trade Union reforms. The Government proceeded to consultation without amending the RIAs and the Opinions were duly published on 18th August 2015 on the RPC website.[20]

Since the inception of the better regulation framework, there have been a number of important changes, illustrated in Figure 7.2. The most important changes are discussed in the following paragraphs.

Figure 7.2. **Evolution of the better regulation framework**



Source: RPC (2015a), "Securing the evidence base for regulation: Regulatory Policy Committee scrutiny in the 2010 to 2015 Parliament", Regulatory Policy Committee, March, p. 35.

The introduction of the fast track process

Departments had expressed concern over the amount of time they needed to build into their timetable for RPC scrutiny of impact assessments and to receive a fit for purpose opinion. Cost-benefit analysis should of course be guided by the principle of proportionality. In other words, the effort to undertake the cost-benefit analysis should be commensurate with the level of expected impacts.[21] Up to 2012, there existed a single process that took no account of the size or significance of proposals. In August 2012, the Government introduced a new fast track procedure for proposals with a gross cost to business and civil society organisations below £1 million a year and for all deregulatory measures. This process sought to ensure that i) the collective efforts of Whitehall and the RPC are focused on the most significant regulatory changes; and ii) deregulatory proposals are brought forward more quickly. The RPC estimates that approximately 70% of in-scope proposals have a cost or saving to business each year of less than £1 million but little impact on the overall account. This suggests that the introduction of a more streamlined and focused process has been worthwhile, given the large number of small regulatory changes going through the system.[22] In the current Parliament, the fast track process continues for deregulatory measures and measures with low gross costs to business (provided in the case of EU legislation that there is no gold-plating). An important difference, however, is that departments are now free to self-certify measures for the fast track, although this right may be withdrawn if the RPC finds at validation stage that any department is not able to consistently apply the fast track criteria.[23]

Initial Review Notices

A further simplification of the process was the introduction of Initial Review Notices (IRN) after a pilot exercise carried out during 2015. An Initial Review Notice is issued to a department as soon as possible after the RPC first identifies a problem in an IA that would lead to a red-rated Opinion. Departments were concerned that when they received a red rating after the RPC had completed its full scrutiny process; taking up to 30 working days, their timetable for parliamentary passage of the measures could be compromised. Under the IRN system, the department receives early warning of potential red points and has 15 days in which to respond. In most cases the department is then able to resolve the problem and receives a Green Opinion on resubmission, although the scoring of departmental performance will be based on the initial submission rather than the resubmission. Evidence from RPC stakeholder surveys and discussion with departments suggests that the IRN process is generally welcomed.

Increased transparency of out of scope measures

Transparency has been enhanced by a number of initiatives, including increased scrutiny by the RPC of measures that are not in scope of the Government's deregulation target. A substantial proportion of United Kingdom regulation originates in the EU or other international institutions and this remains out of scope of the Government's target. Nevertheless, in the interests of transparency and balanced reporting, the Government asked the RPC to validate, from 2013 onwards, the impact of the transposition of all significant EU regulatory measures that affect business. The RPC now scrutinises new EU measures with the same degree of rigour as domestic regulation and expects RIAs supporting EU requirements to provide a robust assessment of the costs and benefits.

Bringing independent regulators into the picture

Until 2013, proposals by independent regulators to change their operational policies, processes or practices were outside the scope of RPC scrutiny. To improve transparency and accountability of regulators' decisions, the Government first introduced the Accountability for Regulator Impact (ARI) process in July 2013.[24] However, ARI was superseded by the extension of the RPC's scrutiny role in the current Parliament to include the validation of the costs and benefits of regulatory changes made by independent regulators. Extending the requirements to the activities of regulators will help the reported figures for business impact to reflect more closely how businesses experience regulation.[25]

Impacts on Small and Micro Business

It is widely accepted that, for well-established economic reasons, small and micro businesses are often disproportionately affected by the burden of regulation. In order to address this, in April 2011, the United Kingdom Government introduced a three-year freeze on new United Kingdom regulation for businesses with fewer than ten employees and start-up businesses. Known as the micro-business moratorium, the freeze applied to business regulation that came into force up to 31 March 2014. Subsequently, for any new regulatory proposal coming into force from 1 April 2014, departments are now required to undertake a small and micro-business assessment (SaMBA). Such assessments identify whether proposals are likely to have disproportionate impacts on smaller businesses and are expected to set out proposals to exempt small businesses or mitigate the impacts on

them. The RPC was given a new role in checking these assessments and is empowered to issue a Red Opinion if the SaMBA is inadequate.

In summary, the independent scrutiny system that has evolved over the last 7-8 years in the United Kingdom provides a powerful incentive for good quality impact assessment to be undertaken on new regulations with significant impacts on businesses, large and small, particularly for the assessment of direct costs and benefits to business. Even measures that are not covered by the Government's Business Impact Target are subject to transparency requirements, enabling external observers to draw their own conclusions about trends in the cost to business of new regulation. Process improvements have, over time, encouraged a focus on the more significant measures and those affecting small firms disproportionately.

Budget constraint and target

While independent scrutiny is important in promoting good impact assessment and giving added credibility to Government claims about the business burden, it will not necessarily deliver a more efficient regulatory regime. Businesses may still be faced with what they perceive to be over-regulation. Independent scrutiny and other features may improve regulatory quality and prevent bad regulation from being imposed, but this will not in itself reduce the stock of regulation or stem the flow of new regulation with which businesses have to comply.

One way of addressing this is the introduction of some form of regulatory budget or target limiting the amount of regulation that can be introduced. Such a limit serves two purposes. First, just as the Government is constrained in its fiscal expenditures by public spending rules reflecting the capacity of the economy to pay tax and absorb debt, controls on the amount of regulatory cost can help prevent the burden of regulation rising without limit (or reduce it to a desired level if that is the Government's priority).

Second, a regulatory budget or constraint interacts with the scrutiny function, giving more power and influence to the independent scrutiny body. If the government as a whole or government departments have to observe a regulatory budget constraint, or meet a target, then the assessment of regulatory impact becomes more than a routine exercise – it directly affects the ability of policymakers to achieve their policy objectives through regulatory means (as is the intention). In the United Kingdom context, the controls introduced over the last few years on the amount of regulatory cost that can be imposed by departments serve to enhance the RPC's role in independent scrutiny.

Since 2010, the United Kingdom has had two forms of regulatory control target. For the 2010-15 Parliament, the Government set a target that the cost of domestic regulation to business would be lower by the end of Parliament than at the beginning. The RPC was able to verify (RPC, 2015a) that, for the proposals in scope of the target, the burden of regulation on businesses and civil society organisations was reduced by the equivalent of £2.2 billion per annum by the end of the Parliament. For the next Parliament, the Government adopted a Business Impact Target with a definition and degree of ambition set by the Government itself, planning for a £10 billion reduction over the five years of the Parliament, similar in magnitude to that for the previous Parliament.

These Government targets are buttressed by controls on regulatory costs imposed by departments. This started in 2010 with the commitment in the Coalition Government programme for 2010-15 to adopt a "one-in-one-out" rule under which no new regulation could be brought in without other regulation being cut by a greater amount. The aim was

to bear down on the volume and cost of regulation and promote a culture change across the United Kingdom Government in its approach to regulation. Departments were expected to meet the one-in-one-out rule across their regulatory activity as a whole, not for each individual measure. Some departments were more successful than others and the degree of ambition was raised in 2013 when the one-in, one-out rule was replaced with one-in, two-out.

In the current Parliament, the degree of ambition has been raised further with the introduction of a one-in, three, out rule (OI3O). Departments now also have their own regulatory 'budgets' – targets for deregulation, totalling £15.8 billion for the current Parliament – more than the Government's overall target to allow for slippage in meeting departmental targets. According to the NAO (2016), departments are not yet confident that they will meet their targets, partly because many of the easier options for reducing regulatory costs have already been taken, but they say the setting of targets has helped raise the profile of better regulation in departments.

The Business Impact Target, OI3O and departmental regulatory budgets all use figures which have to be taken from impact assessments validated by the RPC. This is one of the key institutional features cementing the role of independent scrutiny in the United Kingdom system and promoting better regulatory impact assessment.

Buy-in from stakeholders

An effective regulatory impact assessment process needs to secure high-level buy-in from politicians, civil servants and wider stakeholders to improve both the information used within RIAs, and their contribution to the wider policy development process. Stakeholder engagement can be vital in building confidence that the Government only regulates for good reason. It can also, through consultation, improve the availability and robustness of the information regarding potential impacts, as businesses are often best placed to provide evidence of the economic impact. By extension, greater involvement of stakeholders should result in more robust assessments of the likely impact of regulatory reform proposals and promote shared ownership of the policy objectives and delivery.

In the United Kingdom system, the main business groups and a number of civil society organisations, including the Trades Union Congress (TUC), support the need for an independent scrutiny function and have expressed support for the RPC[26]. The RPC communicates directly with business groups and other stakeholders, through press releases, correspondence, bilateral meetings and attendance at each other's events. In particular, business groups and representatives of civil society see value in the work done by the RPC to help ensure that the Government brings forward new regulation only when it is supported by a robust evidence base and that the Government's claims about the savings to business generated by one-in, one-out and one-in, two-out are accurate. Indeed, the Federation of Small Businesses (FSB), Confederation of British Industry (CBI), Institute of Directors (IoD), Engineering Employers Federation (EEF) and British Chambers of Commerce (BCC) were among those arguing for the RPC to be put on a statutory footing (RPC, 2015a).

Engagement of stakeholders is perhaps made easier in the United Kingdom context by the long history of better regulation initiatives in the United Kingdom. De Francesco et al. (2011) identify the United Kingdom as one of the countries that has set the agenda for this regulatory innovation since the 1980s with some form of compliance cost assessment. Government departments have had better regulation units and better

regulation champions in place for some time, and departments have long been conditioned to lead concerted efforts to improve regulatory performance.

The RPC publishes an Annual Report and other periodic reports and invites stakeholders to attend its monthly meetings and launch events. About 40 attended the July 2016 launch of its annual report (RPC, 2016a). Wider stakeholder engagement is also facilitated by the publication of IAs and Opinions, which often prompt comments from business organisations and others.[27] Five red-rated assessments generated significant interest in parliamentary debates and public discussion of the proposals, namely those relating to the Financial Conduct Authority cap on payday lending, reforming the regulatory framework for employment agencies and employment businesses, trade union registers of members, biodiversity offsetting and capping the charges in auto-enrolment pension schemes. The RPC has warned that taking forward policy proposals in the absence of a Green opinion has the potential to undermine the credibility of the framework, particularly where cases are high profile or politically contentious (RPC, 2015a).

The National Audit Office also plays an important role in the oversight of the RIA process. Its primary role is to scrutinise public spending on behalf of Parliament, helping it to hold government departments to account. It regularly reviews the regulatory reform agenda and the resource devoted to it as part of its value-for-money programme and has reported on aspects of the regulatory reform process annually since 2004. Recent reports suggest that use of quantification in analysis for impact assessments has been improving, and that departments have increased the resources and analytical expertise allocated to preparing impact assessments. NAO (2011) assessed that the Better Regulation Executive, created in 2005, and departments have developed important elements of a structured approach to achieving sustainable reductions in regulatory costs and have delivered significant benefits. However, the NAO remains critical in other respects. For example, NAO (2011) found that departments are not communicating effectively with businesses, who find it difficult to keep up with the extent of new regulation and changes to legislation. Partly in response, the NAO, together with the Better Regulation Executive (BRE) and the Better Regulation Delivery Office (BRDO) and Department for Environment, Food and Rural Affairs (Defra) have commissioned surveys to determine business views on the extent of the burden of regulation, both in general and in specific regulatory areas. Such surveys (for example, NAO and BIS, 2014) are themselves a way of engaging with stakeholders and, as indicated in the introduction, reveal an encouraging trend.

Stakeholder engagement could be further encouraged by better use of *ex post* evaluation, or post implementation reviews (PIRs). The NAO has expressed concern that departments have not been taking a systematic approach to the evaluation of the impact of regulation and no overall attempt has been made to review the total number of regulations that businesses face. Best practice would be for departments to set out their plans for undertaking PIRs when taking forward new proposals, but this is rarely done in any detail. Too often, departments do not give enough attention to data collection and analysis as part of policy proposals from an early stage. If planned and undertaken correctly, PIRs can contribute to a cycle of continuous improvement for policy-makers, resulting in improved and more accurate analysis over time. But by 2016, the RPC had only received a handful of PIRs for review and has expressed concern about the slowness with which PIRs for the most significant measures are coming forward (RPC, 2015a; 2016a).

Of course, government departments are important stakeholders too. The system is not costless to run and the NAO has reported (NAO, 2016) that some departments complain that the bureaucracy and complexity associated with the better regulation framework diverts resources away from what they see as genuine deregulatory activity. The NAO estimate that departments' Better Regulation Units cost £2.3 million per year, while the BRE and RPC together cost £4.1 million in 2015-16. Further unquantified costs are incurred by departmental policy teams or regulators. Although these costs are small compared with departmental budgets and the total costs and benefits of regulation, if the system becomes excessively costly, this will reduce buy-in from departments and Ministers.

Codified methodology

Stakeholders will have greater reassurance that there is a rigorous framework and systematic process for regulatory scrutiny if there is transparency about the methodology and consistency in the way it is used across, and within, Departments and regulators. In order to promote greater transparency and consistency, a number of guides have been published which together codify the methodology and how it should be applied.

The basic source of guidance for departments is the *Better Regulation Framework Manual* (BRFM). The manual, last published in March 2015 (BIS 2015), is intended for departmental policy-makers, statutory regulators, members and staff of the RPC, and others including economists, social researchers, lawyers and those specialising in better regulation. The requirements set out in the manual, supplemented by Q&A documents available to departments, provide all the guidance needed to comply with the regulatory framework.

The technical guidance on cost benefit analysis in the manual derives in turn from the *Green Book* (HM Treasury, 2011b), the United Kingdom Government's standard guide to the techniques and issues that should be considered when carrying out cost-benefit assessments. The Green Book is a best practice guide for all central departments and executive agencies, and covers projects of all types and size. It aims to make the appraisal process throughout government more consistent and transparent. The guidance emphasises the need to take account of the wider social costs and benefits of proposals, and the need to ensure the proper use of public resources.

Complementing the Green Book, the *Magenta Book* (HM Treasury, 2011a) is the recommended central government guidance on evaluation setting out best practice for departments to follow. It presents standards of good practice in conducting evaluations and seeks to provide an understanding of the issues faced when undertaking evaluations of projects, policies, programmes and the delivery of services. While the Green Book covers the whole policy cycle, the Magenta Book provides further guidance on the evaluation stage of the policy process. Central government departments and agencies are asked to ensure that their own manuals or guidelines are consistent with the principles contained in the Green Book and Magenta Book, which are widely accepted in Whitehall as the key references.

While the framework and methodology is thoroughly codified in the BRFM, Green Book and Magenta Book, inevitably new issues arise that require interpretation of the guidance and decisions on its practical application. The Regulatory Policy Committee has therefore developed a series of case history documents (RPC, 2016c) which provide practical guidance, with case study examples, of how the better regulation framework methodology has been interpreted. This is intended to provide policy makers and analysts

with a practical guide on how novel or contentious methodology issues have been approached in the past, and the outcomes of the RPC scrutiny in those cases. The intention is to help departments interpret the formal guidance and promote consistency in its use. An example is given in Box 7.3.

Box 7.3. Amendments to the Pension Schemes Bill (private sector defined benefit transfers)

The proposal required employers to provide free independent financial advice for employees when they are moved from a defined benefit to a defined contribution pension scheme. The department originally counted the additional income to independent financial advisers (IFAs) as a benefit to business, offsetting the costs to employers.

The RPC decided that the income to IFAs was simply the counterpart of the compliance cost to employers and should not be used to offset it. In other words resources used in complying with regulation should not be counted as a benefit to the service provider. In explaining its reasoning, the RPC noted that if an employer had its own in-house financial advice team, and could use it to meet the requirement, it would be perverse to conclude that the regulation had no net cost to that business.

Source: RPC (2016c), "Case Histories web page", http://regulatorypolicycommittee.weebly.com/case-histories.html (accessed 25 August 2016).

The existence of clearly written and codified methodology and guidance is one of the bulwarks of the regulatory control system. It contributes to transparency and consistency and builds confidence, although of course it does not completely dispense with the need for judgement in some circumstances. Specific methodological issues, together with some other case study examples of how the framework has been applied, are discussed in the next section.

Methodology issues

In this section, we consider some of the methodology issues in a RIA system. In particular, we examine:

- definition of business impact target
- choice of metric for target/budget – the EANCB
- alternative metrics
- direct versus indirect impacts
- good practice in IA methodology
- limitations of CBA.

Definition of Business Impact Target

As mentioned in the preceding section, the SBEE Act requires the Government to publish an overall target for the economic impact of new legislation for each Parliamentary term, as well as a mid-point milestone target. For the 2015-20 Parliament, the United Kingdom Government has set itself a target of a saving of £10 billion in net costs to business from qualifying measures that come into force or cease to be in force during this Parliament. An interim target of £5 billion was set for the savings to be achieved in the first three years of the Parliament.

Under the Act, the measures that are in scope for the Business Impact Target are described as "regulatory provisions", defined as statutory provisions that either:

- Impose or amend requirements, restrictions or conditions, or set or amend standards or guidance in relation to the activity; or
- Relate to the securing of compliance with, or the enforcement of, requirements, restrictions, conditions, standards or guidance.

The Government must then decide the categories of regulatory provision that are to be scored against the target ("qualifying regulatory provisions"). The scope of the qualifying measures included within the definition of the target was set out in a written statement submitted to Parliament on 3 March 2016 (United Kingdom Parliament, 2016). Qualifying regulatory provisions are defined as those that do not fall within any of the exclusions listed in the statement, and reproduced as Annex C.

The definition used by the Government has attracted some criticism (NAO, 2016; RPC, 2016a). In the first place, the definition of "regulatory provisions" specifically excludes taxes and duties, tax administration, conditions associated with procurement contracts or grants and short-term provisions that have effect for a period of less than 12 months. Businesses might generally regard these as just as burdensome as regulations falling within the definition and the NAO has pointed out some of the exclusions are quantitatively more important than included measures. Against this, the Government states that HM Revenue & Customs has a target to reduce the annual cost of tax administration to businesses by £400 million by 2019-20. Thus the cost of tax administration, which is most similar to the regulatory cost included within the BIT, is subject to a separate target. But some business organisations have called for the RPC to scrutinise tax administration costs as well as regulatory cost. As regards tax and other charge, taxes paid by business and fees and charges are documented elsewhere in the Government accounts and so, from a transparency point of view, there is some justification for excluding them if the Business Impact Target account is seen as a complement to the tax account.

Self-regulation and co-regulation are also explicitly excluded. As long as they do not result from an implicit threat from Government to regulate in the absence of such self-regulation, it seems justifiable to view these as being outside the scope of a regulatory target or budget.

Some exclusions have been carried over from the one-in, one-out system adopted in the 2010-15 Parliament, principally those relating to fines and penalties, measures to promote competition, large infrastructure projects, the National Minimum Wage, EU regulations and systemic financial risk. RPC analysis (RPC, 2015a) has shown that EU regulation and regulation to reduce systemic financial risk (much also stemming from the EU, but required to deal with the aftermath of the financial crisis) accounted for some of the largest burdens in the 2010-15 Parliament. However, EU measures are excluded on the grounds that they are not fully within the control of United Kingdom ministers. A similar argument may be made for the National Minimum Wage, where the recommendations originate from an independent body the Low Wage Commission, and year-on-year increases generally consist of a routine uprating based on the state of the labour market.

Although EU regulation is outside the target, the estimates of business impact are published and the Government has sought to encourage reductions in the costs incurred by business as a result of European Union regulation. It has supported the European

Commission's REFIT programme (European Commission, 2015), which has the goal of making EU law lighter, simpler and less costly.

Other exclusions carried over from the earlier parliament, and codified more clearly, relate to regulations designed to promote competition or implement large infrastructure projects. Part of the justification for excluding these is that the longer term indirect benefits to business and the economy are expected to outweigh any short term direct cost, as competition and infrastructure investment drive improved business productivity and innovation.

Many of the new exclusions arise from the extension of the target to include regulator activity. Certain activities related to economic regulation are excluded for similar reasons to the exclusion of competition measures. Many of the other exclusions derive from the broad definition of regulator activity that has been adopted in the Act. In order to capture all relevant regulator actions, the statutory definition of a regulatory provision has been drafted in such a way that every action of a regulator in the discharge of its statutory duties potentially falls within scope. The exclusions are intended to ensure that the qualifying provisions scored under target are focused on regulator policies and practices that impose regulatory burdens on business rather than day-to-day activities.

An important new exclusion is the new National Living Wage (NLW), despite the fact that, in going beyond the minimum wage recommendations of the Low Pay Commission, it would normally have scored as a form of 'gold-plating'. The Government claims that introduction of the National Living Wage was offset by changes to national insurance and tax, which are excluded from the target under the Act.[28] However the Government's exclusion of the National Living Wage has been criticised by the RPC and NAO on the grounds that the regulatory account is meant to complement other Government accounts, not reflect all changes affecting business, and that the changes in national insurance and tax are only loosely related to the change in the NLW. Moreover, the introduction of the National Living Wage alongside cuts in personal tax credits, could equally well be portrayed as transferring the burden of support for low paid workers from state spending to business regulation, something a system of regulatory control should be designed to discourage.

Choice of metric – the EANCB

Having defined the target and the qualifying regulatory provisions, a metric is also required. Since the introduction of the one-in-one-out system in 2010, the chosen metric is the direct cost to business (including civil society organisations) as measured by the equivalent annual net cost to business (EANCB).[29] The EANCB of a measure is defined as the annualised equivalents of the present value of its net costs to business, calculated with reference to the counterfactual. Policymakers are required to quantify impacts in accordance with Green Book Guidance (HM Treasury, 2011b) with direct impacts identified and separated. The EANCB is then defined as the constant annual stream of costs that would give the same result as the calculated NPV of (direct) costs to business over the appraisal period. The EANCB is calculated from the NPV of costs, starting from the implementation date (Box 7.4).

Box 7.4. **EANCB**

$$EANCB = \frac{PVNCB}{a_{t,r}}$$

Where $a_{t,r}$ is the annuity rate given by:

$$a_{t,r} = \frac{1+r}{r}\left[1 - \frac{1}{(1+r)^t}\right]$$

Where:

PVNCB = Present Value of Net (Direct) Costs to Business

t = Time period over which the policy is active in the appraisal

r = Discount rate (assumed to be a single discount rate over t, in practice this is invariably the 3.5% rate recommended in the Green Book)

$a_{t,r}$ = Annuity Rate

EANCB = Equivalent Annual Net Cost to Business

According to the methodology adopted by the Government (United Kingdom Parliament, 2016), the impact of each qualifying measure coming into force in the 2015-20 Parliament is assessed on the basis of its Equivalent Annual Net (Direct) Cost to Business adjusted using the GDP deflator to 2014 prices and discounted back to a 2015 present value base year. A worked example is given in Annex D. The contribution to the business impact target is then calculated as the sum of the EANCB over the first five years for which the measure will be in force, or the sum of the EANCB over the full lifetime of the measure for measures that are in force for less than five years. So, having expressed the EANCB in 2014 prices and a 2015 base year, the EANCB is multiplied by a factor of five, unless the measure is in force for less than five years, in which case the factor is the number of years the measure is in force (Box 7.5). (The rationale for multiplying the EANCB in this way is not clear, other than it gives a figure comparable to the amount recorded during the first Parliament for the deregulation savings over five years.)

The EANCB is also used as the basis for Department's "one-in, three-out" (OI3O) accounts and regulatory budgets. Departments calculate their OI3O account by trebling their "INs" (positive EANCBs, measures[30] that are net costly to business) and subtracting their "OUTs" (negative EANCBs, net beneficial to business). If the balance is positive, then the department needs to find more OUTs to balance its OI3O account. Some of the larger departments also have deregulatory budgets, designed to help assure delivery of the BIT through departmental accountability. As previously indicated, the agreed individual budgets total to £15.8 billion, much more than the £10 billion target for the Parliament, a degree of over-programming designed to provide greater challenge to departments and a degree of leeway in case departments fall short of their budgets.

In contrast to the BIT which is the public target, OI3O and deregulatory budgets are designed as internal administrative controls which help departments to deliver the target. The RPC does not validate the OI3O account or departmental budgets, but it does validate the EANCB which is used as the metric for all three control mechanisms.

Box 7.5. **Calculating the contribution of a measure to the Business Impact Target**

For each IN or OUT, the contribution it will make to the Business Impact Target needs to be calculated. The BIT has been set so that the net saving to business over the first five years of the lifetime of each measure introduced this Parliament should be at least £10bn. The contribution is based on the EANDCB expressed in 2014 prices and a present value base of 2015 (see Annex D).

- **Example – A ten-year IN introduced in 2017 with an EANDCB of £12m**

The first five years of the measure will be 2017, 2018, 2019, 2020 and 2021.

Contribution to BIT = 5 x 12 = £60m

- **Example – A two-year time-limited OUT starting in 2016 with an EANDCB of -£20m**

The full impact of the measure will be felt over 2016 and 2017.

Contribution to BIT = 2 x -20 = -£40m

The approximate[1] value of the measure over the two years it is in force, expressed in 2014 prices and a present value base of 2015, is a £40m saving.

1. Approximate because the NPV of the measure is the sum of the discounted stream of EANDCBs over the full appraisal period (e.g. 10 years). Also over the first 5 years of a 10 year measure, the discounted sum of EANDCBs would only approximate the true NPV up to that point if there are no upfront costs/benefits (which EANDCB smoothes out).

Alternative metrics

Alternative metrics have been discussed from time to time because of concerns about focusing on the EANCB and the possible distortions that might arise. At the inception of the system, consideration was given to using the undiscounted costs to business or the present value of net costs to business. Both suffer from disadvantages, the former because it ignores the time profile of costs and benefits and the latter because of the presentational disadvantage of being an order of magnitude larger than the annual costs/benefits. Extending the metric to include indirect costs and benefits to business was also considered but, as discussed more fully below, indirect costs and benefits are often less well evidenced and there is likely to be greater inconsistency in the application of the metric if a wider measure is used. Business experience also suggests that it is the initial impact effect of regulation that is the main concern rather than the longer term residual effects once it is diffused through the economy.

Perhaps the most serious issue about the metric is a concern that a focus on business deregulation could have harmful wider effects. Seven of 14 departments interviewed by the NAO said that there were conflicts between deregulation and their overall policy objectives (NAO, 2016). A wider measure of net present value to society could be used instead but this would not meet the objective of limiting the overall cost of regulation to business. Theoretically, a case could be made for a system which maximises the net present value of the impact of regulatory policies subject to a constraint on the gross or net costs to business, which, if all the required data and control mechanisms were in

place, would be optimal. In fact, despite its imperfections, it could be argued that the current system – with departments empowered to achieve their wider objectives subject to a BIT target and departmental budgetary controls measured in terms of net direct cost to business – does to some extent generate incentives similar to those that would be in place under the notional idealised system.

Direct vs indirect impacts

In the United Kingdom system of regulatory control, the Equivalent Annual Net Direct Cost to Business (EANDCB) metric is designed to capture only the direct costs and benefits to business or civil society organisations. It focuses on those impacts immediately felt by those businesses directly impacted by the regulatory change. Distinguishing between direct impacts and other (indirect) impacts can prove challenging and has been the subject of much debate.

A direct impact on business is defined (United Kingdom Parliament, 2016) as:

"an impact that can be identified as resulting directly from the implementation or removal/simplification of the measure".

Subsequent effects that occur as a result of the direct impacts are indirect. Only direct impacts are scored for the BIT. Indirect effects are not scored in the BIT but may be included in the net present value of the policy to society as a whole. To some extent, distinguishing direct and indirect effects is a general problem in cost benefit analysis. In analysing the impact of spending decisions, issues arise over whether to consider displacement effects, multiplier effects, impacts on employment and unemployment, effects on other regions or on international transactions. But these decisions are even more difficult in the context of the analysis of regulatory impact.

NAO (2016) commented that businesses and departments often do not understand the measure or the complex rules that determine which costs and benefits count are direct. As a result, they expressed concern that the measure does not sufficiently support policymakers' efforts to reduce costs to business. However, it is clearly necessary to draw the line somewhere. Over time, the impact of a regulatory measure will have general equilibrium effects across the economy, as economic behaviour changes, costs are passed on to customers or along the supply chain and businesses enter and exit. Ultimately, all costs to "business" are borne by customers, employees or shareholders. Even if it were possible to identify the final impact of a measure just on shareholders, it is far from clear that this is what businesses understand by the burden of regulation.

In early 2015, the Department for Business, Innovation and Skills (BIS) and the RPC commissioned an independent research project (Titley, 2015), which aimed to:

- set out the different definitions of direct and indirect impacts in the literature;
- present a microeconomic framework for thinking about the treatment of direct impacts within the OIOO/OITO system; and
- develop some criteria that could be used to help officials classify direct and indirect impacts.

The literature review did not identify a single clear definition of the direct impacts of regulations; nor did it point to a clear set of factors to determine the boundary between direct and indirect impacts on business. While the research was not able to identify a strong grounding in economic theory or business experience for the distinction between

direct and indirect impacts, the RPC has, nevertheless, developed guidance on where the line should be drawn, building on the findings of this research project. A summary of practical steps and criteria to distinguish between direct and indirect impacts of regulation on business is presented below, with some examples. The summary of practical steps is based closely on RPC case histories documentation (RPC, 2016c).

Identify the broad type and scope of the regulatory measure

Departments should consider whether the anticipated impacts are consistent with the type of measure being proposed. For instance, an impact is more likely to be direct if it:

- bans, restricts, liberalises, increases or decreases the cost of a particular activity; and/or
- displaces or restricts specific business activities designed to maintain or create sales, e.g. product differentiation and promotional activities.

In addition, impacts falling on those businesses actually subject to the regulation and accountable for compliance are more likely to be considered direct than impacts on businesses elsewhere in the supply chain.

Distinguish between first round and subsequent impacts

Immediate and unavoidable (first round) effects of a measure in the affected market are more likely to be direct. This could involve a shift in either the supply curve (eg due to a change in production costs) and/or demand curve (e.g. from removing a restriction on purchasing a product) or a regulated change in the market price (e.g. imposing a minimum price which moves price away from the market clearing price).

Subsequent effects in the regulated market beyond the immediate implications of the measure are likely to be indirect. These effects occur subsequent to the adjustment to a new equilibrium immediately following the measure. For example, it could be the result of:

- a significant reallocation of resources;
- product and/or process innovation by existing businesses;
- the creation of new firms/institutions; and/or
- productivity gains due to changes in business models or working practices.

It may be useful to think about a 'theory of change' or logic chain along which the regulatory intervention may be expected to impact on the economy. The more complex the logic chain leading from the intervention to the effect, the more likely the impact is to be indirect. Examples of RPC reasoning are given in Boxes 7.6. and 7.7.

Box 7.6. **Amendment to the Energy Act 2008 powers to implement and direct the rollout of smart meters**

Smart meters are a new form of gas and electricity meter that provide the customer with more information about their energy use. The smart meter also provides the supplier with more information, allowing for more targeted tariffs. The policy was to mandate the roll out of smart meters. If smart meters result in more efficient use of energy, this could have large benefits for business users. However, these benefits were considered to be indirect because they result only if business customers choose to act on the information and change their behaviour, rather than as a

Box 7.6. **Amendment to the Energy Act 2008 powers to implement and direct the rollout of smart meters** (*cont.*)

direct result of having a smart meter. This case is purely about giving customers more information on which they can choose whether or not to act. The required behavioural change was, therefore, considered to be an indirect effect.

Source: RPC (2016c), Case Histories web page, http://regulatorypolicycommittee.weebly.com/case-histories.html (accessed 25 August 2016).

Box 7.7. **Standardised packaging of tobacco products**

The measure aims to reduce tobacco consumption by mandating the standardisation of tobacco pack colour, shape and the removal of all branding except brand name in a standardised type face. In this case, the impact of the loss of profit to manufacturers and retailers was classified as direct as it: restricts economic activity from use of branding, prohibits a form of promotional activity, and has a reduction in cigarette consumption of cigarettes as its primary objective. Moreover, if loss of profits from the removal of branding had been regarded as an indirect cost, the measure would have scored as net beneficial to tobacco companies (due to savings in production, branding and packaging costs). Such an outcome would have been widely considered counter-intuitive.

Source: RPC (2016c), Case Histories web page, http://regulatorypolicycommittee.weebly.com/case-histories.html (accessed 25 August 2016).

Identify whether the impact is a partial equilibrium or general equilibrium effect

It may be helpful to distinguish between partial equilibrium and general equilibrium effects. In the case of regulatory interventions, partial equilibrium effects occur in the regulated market while general equilibrium effects occur in related markets and/or the wider economy, as a reaction to first round effects in the regulated market large enough to affect the rest of the economy. Generally, cost, price and/or quantity effects that occur in related markets or the wider economy as a result of changes in the regulated market are second round, general equilibrium effects and, therefore, indirect and non-qualifying against the business impact target.

Consider whether the impact is "pass through"

When a regulatory burden is placed on businesses they have to decide how to respond. They may increase prices, cut wages, reduce investment or reduce dividends. The EANDCB metric is an attempt to capture the burden on business of regulation. If a mechanism exists that enables some or all of this burden to be passed on to other businesses and/or consumers, this subsequent effect is generally regarded as being indirect for the purposes of the BIT. The BRFM (BIS, 2015) states that pass through should be ignored in calculating the EANDCB. The first round impact of the regulatory change, for example the compliance costs to business, is the direct impact of the regulation. The second round impact, after pass through (such as higher prices to consumers) would be an indirect impact of the regulation. Only the direct impact should be included in the EANDCB. Without this rule, any increase in regulatory requirements on business could potentially score as zero on the basis that the cost is ultimately borne

by consumers in the form of higher prices. Exceptions are made, however, when pass through is required by the regulation or where additional costs to an industry-funded regulator are automatically passed on to business.

Although the process and criteria set out above are designed to help distinguish between direct and indirect impacts, it will often remain difficult to judge where the boundary lies between the two. NAO (2016) criticised the current focus on direct costs and benefits as potentially misleading (e.g. in failing to score benefits to business from regulation promoting consumer confidence or the more effective functioning of markets). However, they did not propose any alternative metric in place of direct net costs. Moreover, the NAO concern is to some extent met by some of the exemptions in the system, such as those for financial systemic risk, economic regulation and competition. In the development of these exemptions, it was recognised, explicitly or implicitly, that a metric focused on direct costs could be inappropriate. While the costs to regulated businesses are clearly direct, the wider benefits to new and existing firms, whether from more competition or greater financial stability, would generally be considered indirect and yet there are good reasons from economic theory and analysis to think that such measures should produce a net benefit not just for the economy but for business in general.

The RPC therefore continues to develop, publish and update case study evidence (RPC, 2016c) aimed at giving those undertaking RIAs more guidance on the distinction between direct and indirect effects. While this may seem an esoteric topic, in practical terms, the quantitative significance of this distinction and its importance for the credibility of the system should not be understated.

Good practice in IA methodology

There are many guides available on good practice in RIA methodology, including OECD recommendations (OECD, 2012). In the United Kingdom, as previously indicated, methodology is codified in the form of the Green Book, the Better Regulation Framework Manual (which incorporates advice on Impact Assessment methodology) and RPC guidance and case histories. The following recommendations are based closely on the "principles of good impact assessment" published by the RPC.[31]

Don't presume that regulation is the answer

A good impact assessment should begin by identifying clearly the market, regulatory or systems failure that necessitates government intervention, or in the case of a deregulatory measure, why intervention is no longer justified. The policy objective should be set out clearly and in specific terms, with a clear statement of the nature of the problem to be solved and an indication of its scale. The costs, benefits and risks of not intervening should be discussed, including whether market forces might resolve the problem without government intervention. Lastly, the ability of the regulatory intervention to correct the causes of market failure should be clearly demonstrated and any potential adverse consequences and/or behavioural impacts taken into account.

Take time and effort to consider all feasible options

At consultation stage, it is important that the RIA should consider a sufficiently wide range of realistic options to allow stakeholders to comment on the best approach. Each of the lead options should be appraised with a sufficient level of detail, proportionate to the impacts of the measure and the likely efficacy of the option. In selecting options,

policymakers should draw on evidence from other countries or jurisdictions to achieve similar policy objectives. Where appropriate, consideration should be given to whether non-regulatory alternatives could achieve the policy objectives. In addition, policymakers should include information on any policy options ruled out earlier in the policy cycle and explain the reasons why. The IA should not rule any option out of detailed appraisal without substantive reasoning or clear evidence.

Box 7.8. **Closing the gender pay gap**

The regulations require companies with more than 250 employees to publish the following figures annually: a) mean and median gender pay gaps; b) mean and median gender bonus gaps; and c) the number of men and women in each quartile of the company's pay distribution.

The Government previously pursued alternatives to regulation and the results were considered in the Impact Assessment. In particular, since 2011 the Department encouraged large employers to voluntary publish gender pay gap information through the "Think, Act, Report" initiative. However, only 5 out of almost 280 employers who signed up to the voluntary initiative published the information. The Impact Assessment explains that while the gender pay gap has slowly fallen over the last five years, decreasing from 19.85% in 2010 by 0.75% to 19.1% in 2015, the voluntary approach would be very unlikely to achieve the policy objective of accelerating the reduction in the gender pay gap over time.

Source: RPC (2016c), Case Histories web page (accessed 25 August 2016). Available at http://regulatorypolicycommittee.weebly.com/case-histories.html.

Gather substantive evidence

Evidence must be included explaining how markets currently work and how any identified market or regulatory failure is causing the behaviour and adverse impacts that the proposal seeks to address. Evidence based on statistical sources, empirical studies or *a priori* economic or other analysis should be included, where available. If a public or stakeholder consultation has taken place, evidence gathered during the consultation should be used to inform the estimates of impacts. Where evidence has not been provided, the IA should explain what steps policymakers have taken to seek to fill the evidence gap. In addition to consultation evidence, information from relevant other government departments or public bodies should be used to inform the estimates of impacts presented in the RIA. Of course, data and access to good data is always an issue. Even in countries with good data systems, the data required for an Impact Assessment may well not be readily available. Policymakers must therefore start gathering evidence, speaking to key stakeholders and drafting the RIA early in the policy development process. Too often, data strategies are not considered until the last minute, making it more likely that the evidence base will not meet better regulation requirements and clearance will be refused or delayed. It is recognised that data availability will vary depending on the subject area. Where good quality data is readily available, it would be expected that this would be used in analysis. However, where new research would need to be commissioned to gather the required data, this should only be undertaken where this is cost-effective. The Better Regulation Framework Manual gives some guidance on the degree of quantification required at different stages of the policy development process (Table 7.2).

Table 7.2. **Illustration of levels of quantitative analysis by policy stage**

Policy development stage	**Progression of quantitative analysis – assuming full quantification is possible and proportionate**				
	Identify	Describe	Quantify	Partially monetise	Fully monetise
Development	✓	✓	?	?	x
Options	✓	✓	?	?	x
Consultation	✓	✓	?	?	?
Final	✓	✓	✓	✓	✓
Enactment	✓	✓	✓	✓	✓

Source: Better Regulation Framework Manual BIS (2015), “*Better Regulation Framework Manual: Practical Guidance for UK Government Officials”,* Department for Business, Innovation and Skills, London.

Produce reliable estimates of costs and benefits

The RPC will be looking for supporting evidence and analysis in the Impact Assessment to underpin the estimates of costs and benefits. It is one of the Committee’s key roles. The most important requirement at the outset is to establish and assess the correct counterfactual scenario (the “do nothing” option) – how the market would evolve in the absence of the policy intervention. This will not necessarily be a continuation of the status quo. Building on this, the RIA should ensure that all relevant impacts of the regulatory proposal have been identified, including any indirect consequences. To the extent possible, all costs and benefits should be monetised, based on sound evidence, with a particular focus on direct impacts and particularly, in the current United Kingdom context, the costs to business that are to be scored against the Business Impact Target. Given the central role of this metric in the United Kingdom regulatory scrutiny and control system, the Equivalent Annual Net Direct Cost to Business (and other Present Value measures) should be calculated correctly, using appropriate discount rates, price deflators and appraisal periods. Finally, the most likely and most significant risks and uncertainties should be identified and their potential effects on the measure’s impacts should be analysed, for example through sensitivity analysis.

Assess non-monetary impacts thoroughly.

Not all impacts can be measures satisfactorily in money terms, but it should still often be possible to give some indication of the scale of non-monetary impacts. Where possible, the non-monetised impacts should at least be presented in a way that enables them to be systematically and clearly considered and compared across the different options. Techniques are available for the appraisal and quantification of non-monetised impacts and should be used where proportionate to do so. It is also good practice to consider wider impacts, for example on income distribution and inequality and impacts relating to the public sector equality duty.[32]

Explain and present results clearly

Impact Assessments should be drafted to include all necessary information and omit extraneous detail. In the United Kingdom system, Government officials responsible for completing Impact Assessments are encouraged to use a standard template to ensure that results are presented in a standard form.[33] The magnitude, timing and incidence of costs and benefits should be clearly set out for each option, including setting out the reasoning and calculations clearly. Sources should be given for the data, research and evidence used and the robustness of each of these clearly demonstrated. The IA should explicitly

acknowledge any areas where the evidence is lacking or where analysis is partial or lacking on grounds of proportionality. It should describe the efforts taken to gather relevant information, even if those approaches were not successful

The IA should also include the detail needed to assess the measure against any regulatory control target or budget. Specific to the United Kingdom's regulatory control regime, the IA should include a classification for the measure under the Business Impact Target. It should demonstrate clearly how the EANDCB and the Business Impact Target Score been calculated for each option. If the measure is considered to be a non-qualifying provision, it should be explained clearly why this is the case. If the measure is of EU origin, the IA should demonstrate that it has been implemented at minimum cost with no "gold-plating".

Assess impacts on small and micro businesses

Given the disproportionate burden that regulation can impose on smaller firms, there is a case for giving special attention in IAs to the impact of regulation smaller firms. In the United Kingdom regulatory control system, this is formalised as a Small and Micro Business Assessment (SaMBA). Regulatory measures should only extend to small and micro-businesses where any disproportionate burden is fully mitigated. In order to limit any disproportionate effect, the default is that there will be a legislative exemption for small and micro-businesses where a large part of the intended benefits of the measure can be achieved without including them.

In undertaking a SaMBA, policymakers should consider in the IA the size of businesses and distribution of sizes in the affected markets, analyse the percentage of the policy's costs that accrue to small and micro businesses and estimate what proportion of the policy's benefits could be achieved while exempting small and micro businesses. If the evidence shows that a sufficient proportion of the intended benefits from regulation can be achieved without including small and micro businesses in the scope of the regulation, an exemption should be applied (Box 7.9. for example). If an exemption is not given, the policy should include mitigating measures for smaller firms or the IA should explain why exemptions or mitigations are not possible.

Box 7.9. Legislation to require energy suppliers to provide key, personal information on consumer bills in a machine readable format

The objective of the proposal was to require energy providers to place a small machine readable image, such as a bar code or Quick Response (QR) code, on all domestic retail consumers' paper energy bills. When scanned by a generic reader, this image will provide access to 12 key pieces of consumption data in a manner that is easy to understand.

The Department's original final stage IA was red-rated by the RPC on the basis that the Department had not provided sufficient evidence that the objectives of the proposal required the inclusion of small and micro businesses.

On re-submission, the Department provided data indicating that 10 energy suppliers are believed to be small or micro businesses, with a total market share estimated to be around 0.2%. The same businesses were, however, expected to bear 3.2% of the costs associated with this policy. The impact on small businesses was therefore considered to be disproportionate. The Department accepted that a full exemption should be applied because the vast majority of the policy benefits could still be achieved.

Source: RPC (2016c), "Case Histories web page", http://regulatorypolicycommittee.weebly.com/case-histories.html (accessed 25 August 2016).

Include a review plan

Ex post evaluation of regulation is as important as for spending policies. Good evaluation can provide information on the design and implementation of a regulation and its effectiveness, promoting not only accountability for the regulatory cost imposed but also lesson-learning that can help inform future policy. For proper *ex post* valuation to be possible, it is imperative that the IA include a review plan to update the quality of evidence available after the measure has been implemented. The IA should specific information on how the policy's success in meeting its objectives will be measured and on how the costs of the policy will be monitored. The post implementation review Plan should specify what data need to be collected before and during implementation phase and what data should be collected as the policy is being implemented, including how stakeholders will be consulted and their feedback reflected.

Limitations of CBA

Cost benefit analysis (CBA) is consistently promoted by the OECD as the desirable standard in conducting RIAs, but in practice the experience varies considerably internationally. Even amongst countries and administrations with a tradition of regulatory scrutiny, there is some variation (Table 7.3). In the United Kingdom, regulatory impact analysis is firmly rooted in CBA, based on Treasury Green Book guidance originally developed for spending decisions. It is also the preferred method in Australia, United States and Canada (Tiessen et al, 2013; Treasury Board of Canada Secretariat, 2007) and other OECD countries. EU Impact Assessment guidelines encourage "cost-benefit thinking", though CBA is only one approach for comparing impacts. Germany and some other European countries put more emphasis on counting the costs of regulatory change and less on quantifying or monetising the benefits. However, even those countries who aspire to full CBA acknowledge the difficulty in monetising and quantifying all impacts of a regulatory proposal and thus also allow for partial CBA or the use of other techniques, such as cost effectiveness analysis or multi-criteria decision analysis.

Analysis by RPC (2016a) suggests that United Kingdom Government departments could do better in quantifying wider impacts on society of regulatory proposals. The RPC warns that failure to do so could have adverse consequences for the quality of policymaking. RPC (2015a) highlighted concerns regarding the rigour with which societal impacts are appraised in impact assessments. During 2014, only one third of proposals seen by the RPC provided a quantified assessment of the effects on wider society. For measures that have come into force in the current parliament, RPC (2016a) states that the proportion has increased to around 60% (24 out of the 41 measures requiring full impact assessments). But eight of these 24 were assessed by the department as having a net cost to society, which would suggest that either society as a whole is worse off as a result of the government intervention, or that the benefits are not being quantified in full.

One problem is that the better regulation framework currently provides weak incentives for departments to assess the wider effects of regulation on society, as the RPC is unable to reflect concerns about the assessment of wider impacts in its fitness for purpose ratings. The RPC has consistently asked to be given this power in its annual reports (RPC, 2016b).

Table 7.3. **Summary of methods used for quantification and monetisation**

Method/approach	Australia	European Commission	United Kingdom	United States	Germany
Analytical frameworks					
Cost Benefit analysis (CBA)	X	X	X	X	X
Cost-Effectiveness Analysis (CEA)	X	X	X	X	X
Multi-criteria analysis (MCA)		X	X		X*
Methods for quantification ad monetisation					
Willingness to pay/Willingness to accept	X	X	X	X	
Revealed Preferences	X	X	X	X	
Stated Preferences	X	X	X	X	
Value of Statistical Life ‘VOSL) and Value of a Statistical Life Year (VOLY)	X	X		X	
Quality Adjusted Lfe Years (QALY)	X	X	X	X	
And Disability Adjusted Life Years (DALY)	X	X			
Healthy Life Years (HLY)		X			
Cost of Illness		X		X	
Human Capital Approach		X			
Subjective Well-Being Approach			X		
Costs of carbon emission and social costs of carbon		X	X	X	
Life Cycle Assessment Approach		X			

Source: Tiessen, J. et al. (2013), “Quantifying the benefits of regulatory proposals: International practice”, Study prepared for the Nationaler Normenkontrollrat, April 2, Berlin.

Strengthening the analysis of societal benefits would provide insight to Government on where to focus business regulation and inform the trade-off between societal benefit and business cost and help Government focus business regulation. These wider considerations could also inform better regulation policy design, for example in relation to small business assessments and exemptions. Both the RPC and the NAO (2016) have said they would like to see greater emphasis placed on the appraisal of societal benefits by departments and in the better regulation framework.

There is, however, a common fallacy that CBA is only about producing a single number, such as the NPV or EANCB. It is important to recognise that the process, analytical framework and accounting system are in many ways just as important as the final result. It may not always be possible to quantify everything – for example, the benefits of financial stability may be substantial, big enough to have a macroeconomic impact, and yet it is always hard to calculate with any precision the contribution that any particular financial regulation will make to the security of the financial system. There

may also be benefits which are especially hard to quantify in money terms such as child protection, national security, civic pride, trust, etc. In these circumstances, CBA can still be used as a framework but it may be unrealistic or even misleading to produce a single number for the NPV of the proposal to society as a whole.

Moreover, sometimes regulation is driven by distributional concerns rather than efficiency considerations, for example when changing the balance of rights between businesses and customers, between workers and employers, between claimants and defendants in insurance, patent disputes, bankruptcy proceedings and the like. In such circumstances, cost benefit analysis on its own will not tell us much about whether the policy is a good use of resources or not. In some circumstances, it may help identify any deadweight cost or other resource inefficiencies when the balance of rights is changed by regulation but in general the impacts will be dominated by a transfer from one group to another. Sometimes it may be possible to gain insight by using distributional weights, based on the declining marginal utility of income.[34] However, other distributional impacts may also need to be considered, for example differing impacts according to age, gender, ethnic group, health, skill, or location. And a degree of judgement will be required as to whether the distributional changes are in line with society's preferences and how much weight is to be given to those impacts.

Aside from the difficulty of quantifying benefits and wider impacts including distribution, other limitations to cost benefit analysis encountered in its application to regulatory change include the following, not all of them unique to regulatory policy making:

- The importance of implementation in *ex ante* assessments and process evaluation in *ex post* assessments should not be overlooked. An excessive emphasis on the EANCB or NPV or any other single number runs the risk of diverting attention from implementation or from lesson learning from process evaluation, which should be an equally important objective of appraisal. Policy design and implementation issues deserve as much attention in RIA as conventional cost benefit analysis. In the United Kingdom system, Impact Assessments are generally weak on implementation issues but these are considered elsewhere in the policy development process and the Better Regulation Framework Manual does specify that departments preparing a new measure should consider options for how it will be implemented and enforced, taking account of the principles set out in the Hampton Report (Box 7.10).

Box 7.10. **Hampton principles**

- Regulators, and the regulatory system as a whole, should use comprehensive risk assessment to concentrate resources on the areas that need them most;
- Regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take;
- No inspection should take place without a reason
- Businesses should not have to give unnecessary information, nor give the same piece of information twice;
- The few businesses that persistently break regulations should be identified quickly and face proportionate and meaningful sanctions;

Box 7.10. **Hampton principles** (*cont.*)

- Regulators should provide authoritative, accessible advice easily and cheaply;
- Regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work;
- Regulators should recognize that a key element of their activity will be to allow, or even encourage, economic progress and only to intervene when there is a clear case for protection.

Source: http://webarchive.nationalarchives.gov.uk/+/http:/www.bis.gov.uk/policies/better-regulation/improving-regulatory-delivery/assessing-our-regulatory-system.

- Handling risk and uncertainty is a common problem in Cost-benefit analysis, but it is often integral to regulatory impact assessment, particularly for regulations that relate to public risk, i.e. those risks that Government seeks to manage on behalf of the citizen (Bartle and Vass, 2008; Better Regulation Commission, 2008). Examples of public risk would include financial stability, climate change, public health, flooding and animal disease. In all these cases, important externalities are present, justifying Government intervention (though not necessarily regulation) and the benefits must be weighed in terms of the contribution that regulatory and other measures can make to reducing the 'tail risk' of low-probability, high-impact outcomes. Cost benefit assessment is inherently difficult in such circumstances, as the quantitative impact of alternative policy measures on the risk is difficult to assess and yet the choice of policy, including whether to act at all, may be highly sensitive to the assumption made. In these circumstances, some advocate the adoption of a precautionary approach but others express concern that this may produce a bias to over-regulation.[35]
- While it is desirable to put more emphasis on the analysis of alternatives to regulation, constraints on resources are such that it may be disproportionate to undertake an appraisal of all the policy options, even when a distinct set of options is available. However, rarely is the choice facing policymakers a simple one. Typically, in practice, policy packages consist of many elements and countless options can be generated by considering them in different combinations. For example, the 2013-14 reforms to consumer protection undertaken in the United Kingdom and other EU countries in response to the Consumer Rights Directive comprised a raft of individual measures designed to promote confident and informed consumers, with short-term costs to business but longer term benefits in the form of enhanced competition and trust in the market place. Given the complexity of the package, despite the publication of a large number of impact assessments, it was difficult to appraise all the possible variants still less to consider radically different alternative means to achieving the same goals. Cost-benefit analysis can only take policymakers so far in such circumstances. A degree of pragmatism is required in dealing with this – for example encouraging policymakers to reserve the analysis of alternative options for discrete policy choices and make more use of sensitivity analysis rather than options analysis when considering varying parameters. In some cases, it may make sense to disaggregate or aggregate elements of policy packages in a way that allows structured choices among options. In other cases, on grounds of proportionality, a

qualitative account of the reasons for making a policy choice or selecting a policy setting may suffice.

- Finally, one danger (Wegrich, 2011; Tiessen et al, 2013) is that the technical and methodologically sophisticated information provided in RIA reports may lead to less, not more, transparency as far as lay readers are concerned. While it is only right that economists should use state-of-the-art techniques in CBA, analysts and policymakers should take care to avoid spurious precision and to ensure that both the analysis and the caveats around it are explained in clear and simple terms accessible to a general audience.

Given the limitations of CBA, it is often necessary to resort to cost effectiveness analysis where the costs of alternative ways of reaching a given outcome are compared and ranked. In many cases, this may be the proportionate solution. In practice, in RIAs that fail to consider wider impacts, the analysis reduces to a form of cost effectiveness analysis, with little attempt to differentiate policies according to their impact on the policy objective or other benefits. An example of cost effectiveness analysis is given in Box 7.11.

Box 7.11. **Cost-effectiveness analysis**

The outputs to be ranked by cost-effectiveness analysis will often be social or environmental in nature, for example, work in health economics looking at the cost-effectiveness of different treatments. As with CBA, the level of detail for the analysis will typically depend on the specific issue being addressed, but should take a broad view of costs and benefits to reflect all stakeholders.

In 2005 the United Kingdom Government undertook a value for money analysis of Government investment in different types of childcare. The choice was between higher cost "integrated" childcare centres, providing a range of services to both children and parents, or lower cost "non-integrated" centres that provided basic childcare facilities.

The analysis used a variant of cost-effectiveness analysis to allow the comparison of the cost-effectiveness of childcare to other policy areas such as employment, education and crime, where the evidence allowed the analysts to quantify intermediate outputs from the policy (e.g. improved educational attainment aged 18) but not the final outcomes of the policy (e.g. better overall life chances, higher skilled workforce and higher economy wide productivity growth)

Source: http://betterevaluation.org/evaluation-options/CostEffectivenessAnalysis.

However, in cases where the costs and benefits are large and the size and the nature of the benefits differ depending on the intervention, cost effectiveness analysis will not suffice. Another technique often promoted as an alternative to cost benefit analysis is multi criteria decision analysis (MCDA). MCDA is intended to help rank options in contexts where there are multiple criteria, where some may be monetary but others are expressed in non-monetary form. MCDA allows the different elements of the problem to be assessed separately but also provides an overall picture of the performance of all options across all criteria to enable a well informed decision to be made. Maxwell et al (2011) report that MCDA is now widely used throughout the United States, at all levels of government, and DCLG (2009) report that it is increasingly being used in the United Kingdom as a complement to CBA or cost effectiveness analysis. DCLG (2009) includes three case studies on the use of MCDA in the United Kingdom: an evaluation by the National Audit Office of Overseas Trade Services provided by the Department of Trade and Industry; an appraisal for United Kingdom Nirex Limited of potential United

Kingdom sites that might be suitable as radioactive waste repositories; and use of MCDA modelling and decision conferencing by a new unitary local authority to develop a three year strategic plan for the management of their social care budget.

MCDA accepts that benefits are often inherently multidimensional and not always monetisable. Rather than a single score, such as NPV, multi-criteria analysis evaluates projects and proposals by multiple standards – typically six to eight criteria. The strength of multi-criteria analysis is its transparency in reporting complex evaluations, where the scores on the different criteria may vary greatly. It may be particularly well suited to situations where different stakeholders emphasize different objectives. However, the other side of the coin is that the choice of criteria and their relative weighting is subjective and open to debate, so it is by no means certain to lead to unambiguous or unbiased outcomes.

In view of their limitations, CBA, cost effectiveness analysis and MCDA should be used with care. They are best used as an analytical and accounting framework for considering costs and benefits, monetary and non-monetary, and a guide to structured decision making, rather than a tool that is expected to produce a single metric or a unique ranking of policy options. In the United Kingdom RIA system, it is rare to find any example of formal cost effectiveness analysis or multi criteria decision analysis. The guidance steers departments in the direction of full cost benefit analysis and this is the approach used in the majority of cases. When monetisation of wider impacts (usually benefits to wider society such as financial stability, consumer confidence, security, environmental impacts) is not possible, departments default to using a form of cost effectiveness analysis or a multi-criteria approach, though the discussion is almost always qualitative without any use of formal ranking or weighting techniques.

Policy implications

This concluding section draws on the preceding analysis of the United Kingdom system of regulatory control, together with OECD Recommendations on good practice in regulatory policy and governance (reproduced at Annex E), to suggest some preliminary policy findings. The aim is to provide Korea and others with some pointers in respect of the design, implementation and management of programmes of regulatory impact assessment in order to help improve the efficiency and effectiveness of regulatory policy and governance.

The lessons from the United Kingdom experience suggest some institutional prerequisites for deeper embedding of regulatory impact assessment and some methodological challenges which need to be addressed in the design of a system of regulatory control.

The most important prerequisite for a successful system is stakeholder support. First and foremost, political commitment is needed, in particular buy-in from Ministers, Parliament, senior Policy makers and analysts. The OECD recommendations (Recommendation 1) call for commitment at the highest political level to an explicit whole-of-government policy for regulatory quality. This is an area where the United Kingdom already has an established tradition and reputation. To some extent, achievement of buy-in across institutions is facilitated by the United Kingdom's Parliamentary system and the institutional structure that supports better regulation. However, the degree of political commitment is also manifest in, and strengthened by, the creation, from 2015, of a legislative basis for the system of regulatory control. Although it

is early days, the strengthening of the legislative basis through the SBEE Act appears to have added to the credibility of the United Kingdom system and enshrined the role of the independent scrutiny body. However, the RPC had the benefit of having played a similar role for a number of years prior to the SBEE Act and had established a track record and modus operandi. The context and institutional setting is therefore important in judging the appropriate legislative basis and the effectiveness of legislating for budgets, targets and independent scrutiny. The institutional, historical and cultural context must always be taken into account in seeking to learn from other countries.

It is important to build stakeholder support more widely as well. The OECD recommends (Recommendation 2) that the system of regulatory governance should be in line with the principles of open government, including transparency and participation in the regulatory process to ensure that regulation serves the public interest and is informed by the legitimate needs of those interested in and affected by regulation. The OECD has previously identified (OECD, 2010) that the United Kingdom has a well-established culture of open consultations aimed at maximising transparency in the process. In the current setting, transparency is further served by the adoption of a Business Impact Target, publication of annual reports on progress against the target and publication of Impact Assessments by Departments and Opinions and Annual Reports by the RPC.[36] An open approach such as that adopted in the United Kingdom raises the profile of better regulation, helps build confidence in the system and also fosters greater stakeholder involvement at the consultation stage of policy development.

More generally (OECD Recommendations 7-10), it is important to have a network of departments, agencies and other bodies responsible for delivering the system of regulatory control and better regulation agenda, with clear divisions of responsibility and lines of accountability. This includes having the relevant analytical capacities and competences in departments and a strong central body with a coordinating role. At the same time, the cost in terms of resources and bureaucratic burdens needs to be kept manageable, hence the need for streamlining aspects of the system, such as fast track and proportionate treatment for low cost measures and early warning signals (such as IRNs) when the regulatory scrutiny process reveals problems in an impact assessment.

Another pillar of the United Kingdom system is independent scrutiny. The OECD advises (Recommendation 3) that countries should establish mechanisms and institutions to actively provide oversight of regulatory policy procedures and goals, support and implement regulatory policy, and thereby foster regulatory quality. The experience of the RPC, as the United Kingdom's official independent verification body and other independent bodies such as NKR in Germany and Productivity Commission in Australia, points to the value of independent quality assurance and oversight. It is also important that the body responsible for scrutiny has some form of sanction appropriate to the policy-making context and culture, for example the power to delay the passage of a policy proposal. In the United Kingdom, this is secured by requirement for RRC clearance and an understanding that this will only be given in exceptional circumstances if the RPC has not validated the assessment of business impact.

In the United Kingdom, the RPC's role in validating the target focuses minds in departments and regulators on the need to bear down on regulatory cost. The need to obtain RPC validation also adds further leverage to the role of the scrutiny body. This is one of the positive side-effects of a system of regulatory budgets or targets.

The experience of the United Kingdom also suggests a number of lessons in the design of a regulatory budget or target. Although other metrics are possible, a target focused on the business impact would seem to be the most consistent with the needs of competitiveness and the desire to constrain the burden of regulation on the economy. Ideally, the business impact target should be drawn as widely as possible and the degree of ambition set accordingly. Businesses do not generally distinguish between the sources of regulation according to whether it is in the direct control of the Government and would prefer to have a more inclusive target, calibrated according to what can realistically be achieved. Another desirable design principle, which should not be overlooked, is that the regulatory account should serve as a complement to other accounts such as the tax and expenditure accounts so that together they give a complete picture of the impact of Government decisions on business.

Business impact should be defined in terms of a net value measure of the net cost or benefit to business, not by the number of regulations or a categorisation of measures into those which are regulatory or deregulatory. The choice of the exact metric is less important – it can be EANCB, NPV or a stream of annual costs. But it is desirable to avoid frequent changes to the target and to have a consistent framework over time, so that accounts from one regulatory period to another are comparable, allowing progress to be tracked and an overall account maintained.

OECD Recommendation 5 calls for systematic programme reviews of the stock of significant regulation. In the United Kingdom one of the manifestations of this is in the form of "red tape reviews", undertaken by the Cabinet Office.[37] In Australia, the Productivity Commission plays a similar role (OECD, 2010a). There are also incentives in any system of regulatory or budgets for departments and regulators to keep the stock of regulation under constant review in order to find savings to keep to budgets or meet targets. In the United Kingdom, the NAO has criticised departments for not having estimated the size of the total stock of regulation, as opposed to the new flow. But, as long as the stock of existing regulation is regularly reviewed, it is not clear that it is helpful to try to estimate the size of the stock, mainly because that is a conceptually difficult exercise to carry out. It is difficult to imagine a counterfactual of a "no regulation world" and even if the impact of successive regulations could be cumulated over time, it is not clear that this would give a meaningful estimate of the overall burden, as society and the economy adjust in response to the regulatory framework over time.

The other practical challenge in the policy-making process is to make sure that RIAs are integrated with the policy development process (OECD Recommendation 4). Too often, the policy making process proceeds independently and regulatory impact assessment is only done at the end of the policy process as an afterthought. One way to discourage this is to require RIAs to be carried out at each stage in the decision-making process. It also helps if evaluation and monitoring are built in at the beginning of the impact assessment process rather than addressed only at the time of post-implementation reviews.

Another important point to bring out is that RIAs will command more attention and be taken more seriously if they are part of the decision-making process and parliamentary scrutiny. In some countries, RIAs are undertaken as part of the policy-making process but this counts for little if the RIA is then sidelined when it comes to Cabinet decisions. In the United Kingdom, the requirement for RRC clearance, which is normally contingent on the Impact Assessment receiving a fit-for-purpose rating from the RPC, ensures that RIAs are at the heart of decision making. Publication of the Impact Assessment and Opinion

also then ensures that the evidence and analysis contained therein can inform and support parliamentary debate on new primary legislation.

Finally, there is scope to improve benefit modelling within a more integrated approach to impact assessment. Good impact assessment requires an acceptance that, for significant measures, an attempt should be made to monetise as much as possible, using standard techniques e.g. for the valuation of time savings, quality-adjusted life years, modelling, contingent valuation, international evidence and so on. But cost-benefit analysis also has its limitations and it may not always be possible to reduce everything to a single number. For these reasons, the quality of an impact assessment should be judged not only on whether it produces the correct figure for any control total but also on the way in which CBA or other tools are used as an accounting framework and a guide to structured decision making.

Conclusion

This review of United Kingdom experience with regulatory reform and the incentives created by the better regulation framework suggests that there are a number of key features that help promote good quality RIA: a legislative basis for the better regulation framework; an independent body responsible for scrutiny; the additional leverage provided by some form of regulatory budget constraint or target; buy in from stakeholders; and the existence of an agreed and codified methodology.

Implementation of a system of regulatory control and oversight, such as that practised in the United Kingdom, must overcome a number of methodological challenges. In addition to the usual difficulties of undertaking good cost-benefit analysis for regulatory impacts and the broader limitations of CBA as an analytical tool, the challenges include agreeing the precise definition of the business impact target, the metric to be used and distinguishing direct and indirect impacts. The chosen measure of business impact – the Equivalent Annual Net Direct Cost to Business – is not perfect but it has proven to be a useful analytical tool and establishes a common ‘currency’ for the assessment of business impact

This paper draws a number of conclusions about good practice in regulatory scrutiny and governance that may be relevant for Korea. The importance of buy-in from policymakers and business is stressed and this can be bolstered by greater openness to help build credibility. Independent scrutiny, preferably backed by sanctions and the additional leverage of a regulatory target or budget, has further strengthened the United Kingdom framework. A network of agencies with relevant competences is also needed to run a system of regulatory impact assessment and oversight successfully.

Some lessons may also be drawn on good practice in managing and undertaking regulatory impact assessment. RIAs should be integrated with the policy development process and not undertaken as an afterthought; and they should inform decision-making and scrutiny by Parliament and not just be a process for the Executive. There is also plenty of scope to improve benefit modelling, even in frameworks, such as the United Kingdom’s, that require full cost-benefit analysis rather than cost-effectiveness analysis. Finally, while the overall quality of a RIA should be judged on its consideration of the society-wide impact, a focus on the net (value) impact on business may be justified if the objective is to constrain the cost imposed on the business sector and thereby contribute to improved competitiveness.

Notes

1. "Recent developments to strengthen ex-ante impact assessment signal clearly the energetic promotion of a new culture for rule making. There has been considerable progress on ex-ante impact assessment. The United Kingdom is doing far more to promote this than many other OECD countries" (OECD, 2010a).
2. "The vigour, breadth and ambition of the United Kingdom's Better Regulation policies are impressive. This makes the United Kingdom especially well placed among EU and other OECD countries to address complex future regulatory challenges" (OECD, 2010a).
3. http://hansard.millbanksystems.com/written_answers/1993/mar/09/dti-deregulation-unit-social-action
4. Annex A: www.eesc.europa.eu/resources/docs/routes_to_better_regulation.pdf.
5. www.regulation.org.uk/library/2005_less_is_more.pdf.
6. http://ec.europa.eu/smart-regulation/better_regulation/documents/mandelkern_report.pdf.
7. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV%3Al10108
8. www.dei.gov.ba/bih_i_eu/RIA_u_BiH/default.aspx?id=6595&langTag=bs-BA
9. http://webarchive.nationalarchives.gov.uk/20130129110402/www.hm

   treasury.gov.uk/bud_bud05_hampton.htm
10. www.regulation.org.uk/library/2005_less_is_more.pdf.
11. http://discovery.nationalarchives.gov.uk/details/r/C17921.
12. www.legislation.gov.uk/ukpga/2015/26/pdfs/ukpga_20150026_en.pdf.
13. As defined in the Better Regulation Framework Manual (BIS, 2015), gold-plating is where implementation of an EU regulation, decision or directive goes beyond the minimum necessary to comply with the Directive (BIS, 2015)
14. A sub-committee of the Economic Affairs Committee, the RRC chaired by Oliver Letwin until July 2016 met regularly during the 2010-15 Parliament but since 2015 RRC clearance has generally been sought and given through a write-round process. Under Teresa May's Government, the RRC continues, with a similar role and a slightly expanded membership, as a sub-Committee of the Economy and Industrial Strategy Committee.
15. www.gov.uk/government/news/new-cabinet-committee-to-tackle-top-government-economic-priority

16. With regard to the RPC, references to "business" in the context of better regulation, also include, unless otherwise specified, civil society organisations (voluntary and charitable organisations not in the public sector).

17. In May 2016, the scope of the business impact target, and the RPC's role in verifying it, was extended to cover the regulatory activity of over 80 statutory regulators.

18. According to its terms of reference, the RPC may publish any insights it gains, through its scrutiny function, on the operation of the better regulation framework and how well it meets Ministers' stated policy intentions, but it may not comment publicly on any other aspect of Government policy. This protects the independence of the RPC and ensures clear separation between the scrutiny of analysis and evidence (which is the role of the RPC) and policy-making (which is the responsibility of Ministers).

19. Amber ratings were originally used either to indicate changes that "should" be made to an Impact Assessment prior to consultation for a consultation stage IA or prior to publication for a final stage IA. Following a BRE review of the process, the RPC was required to give either a red or green rating at final stage, based only on whether it could validate the final figure for the net impact on business. Ambers were still used at consultation stage, but there was little evidence that departments were revising Impact Assessments prior to consultation in response to an Amber rating. With the introduction of Initial Review Notices (see below), Amber ratings have, since early 2016, been dropped altogether.

20. www.gov.uk/government/collections/red-rated-impact-assessment-opinions-since-may-2015

21. Guidance on what constitutes a proportionate approach can be found in the Better Regulation Framework Manual (BIS, 2015). Authors of impact assessments are advised to ensure that the resources devoted to RIA are proportionate by considering factors such as the scale of the expected impact, stage of the policy, sensitivity of the policy and the feasibility/cost of doing further analysis relative to the benefits it may yield.

22. For similar reasons, Canada introduced a Framework for the Triage of Regulatory Submissions in 2006 (Government of Canada, 2006).

23. So far there is no evidence of departments making inappropriate use of the fast track in this way.

24. Under ARI, non-economic regulators planning a significant change in policy or practice were expected to assess and quantify the impact of that change on business. The assessment was to be shared with representatives of businesses affected, and, if possible, agreed before making the change and then published. The RPC's role was expanded to allow it to assess the best means of resolving disputes in cases where the regulator and business were unable to agree the assessment. However, no such cases came to the RPC. ARI was superseded with the extension in 2016 of the RPC's scrutiny role to include independent regulators.

25. Since the extension of the BIT to cover the regulatory activities of statutory regulators came only in the Enterprise Act 2016, it is still too early to tell how much this will affect the account, but the increase in caseload for the RPC is expected to be substantial.

26. In the view of the FSB, the RPC "provides rigorous testing of the quality of Impact Assessments (IAs) by government departments regarding new regulatory proposals. We believe that the work of the RPC and the high degree of transparency with which

it carries it out has introduced a discipline and rigour to the IA process that has not always been evident in the past. We welcome the overall improvement in IAs to date and want to see it continue." (Quoted in RPC, 2015a)

27. For example, the CBI, in its written evidence to a parliamentary inquiry on the introduction of a statutory register of lobbyists, cited the RPC's Opinion that the impact assessment for the policy did not explain how the proposal would address the causes of market failure or its significance and went on to recommend that the Government should address this point before taking its proposals further.

28. The Government has however accepted that future annual changes to the National Living Wage that do not follow the recommendations of the Low Pay Commission will be in scope for the Target (UK Parliament, 2016).

29. Or equivalent annual net direct cost to business (EANDCB) in the terminology adopted from 2016. The two terms are used interchangeably in this report.

30. The Government has decided that OI3O does not apply to qualifying regulatory provisions that stem from manifesto commitments

31. In the UK, the Public Sector Equality Duty, set out in the Equality Act (2010), requires Ministers to have due regard to the need to advance equality of opportunity, eliminate discrimination and foster good relations between those with and without certain protected characteristics. For an example, see the Impact Assessment prepared in November 2015 by BIS for the introduction of the National Living Wage, Annex 1, pp. 32-37, which can be found at www.legislation.gov.uk/ukia/2016/3/pdfs/ukia_20160003_en.pdf

32. The template can be found at www.gov.uk/government/publications/impact-assessment-template-for-government-policies

33. Guidance on this for UK policymakers is set out in the Green Book, HM Treasury, 2011: 25 and Annex 5.

34. Public risk has been the subject of reports by the Better Regulation Commission (eg, Better Regulation Commission, 2008) and the Risk and Regulatory Advisory Council in the UK (eg, RRAC, 2009).

35. Public risk has been the subject of reports by the Better Regulation Commission (eg, Better Regulation Commission, 2008) and the Risk and Regulatory Advisory Council in the UK (eg, RRAC, 2009).

36. The results of successive business surveys show some evidence of increasing transparency. The 2014 business perceptions survey (NAO and BIS, 2014) showed a significant improvement on all measures related to fairness, clarity and straightforwardness of regulation against 2012 and, to a lesser degree, against 2010. However, the 2016 findings for these measures were generally less positive than in 2014 (BEIS, 2016).

37. https://cutting-red-tape.cabinetoffice.gov.uk/.

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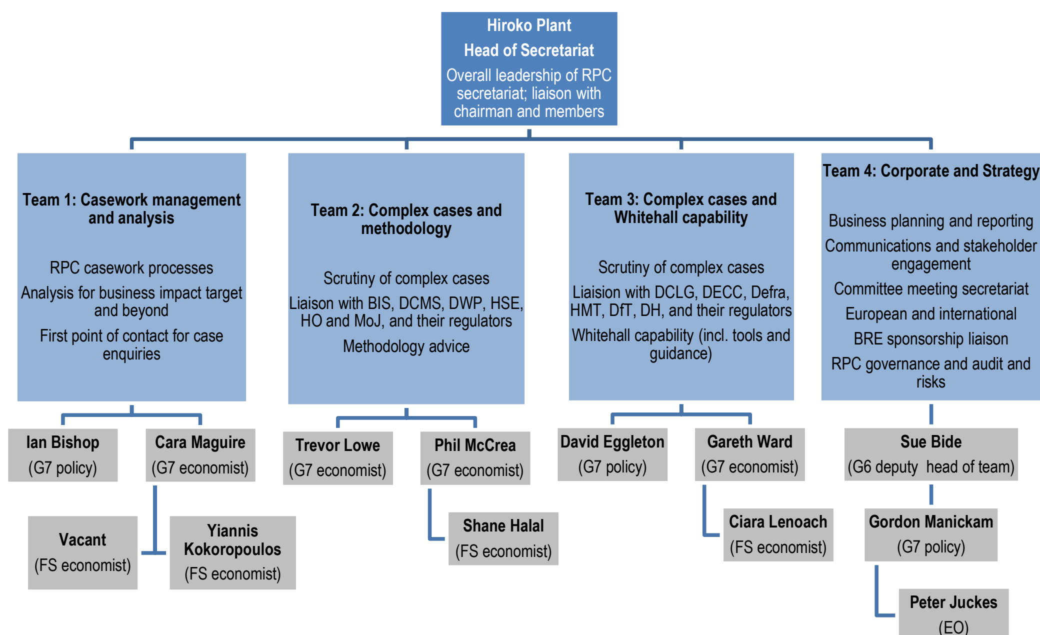
Annex 7.A

Resources involved in United Kingdom better regulation framework

The BRE is currently (December 2016) undertaking a review of the efficiency of the better regulation framework, including costs to departments and regulators of complying with its processes. It is estimated that the BRE cost £3.1 million in 2015-16, and the RPC about £1 million.

The organisation of the RPC Secretariat is shown in the diagram below. The Secretariat provides support to the Chairman and the other seven members of the Committee.

In addition to the cost of the BRE and RPC, the NAO (2016) estimates that the activities of departmental Better Regulation Units cost another £2.3 million per year. There is considerable variation between departments, from an estimated £20 000 to nearly £500 000, depending partly on the scale of the department's regulatory activities. However, this is not a full estimate of administrative costs, since it does not include costs incurred by departmental policy teams or by regulators.



Annex 7.B

Independent scrutiny bodies in Europe

	Regelrådet (Sweden)	Actal (Netherlands)	RIAB (Czech Republic)	RPC (United Kingdom)	NKR (Germany)
Mandate and tasks	• Reviews IAs: YES. Quality reviews IAs accompanying proposals for new or amended laws, ordinances and regulations. Assesses IAs to proposals from the EU Commission upon requests from ministries and recommends what is needed for a complementary Swedish IA • Institutions advised: Govt, Government agencies	• Reviews IAs: YES, in two phases – formal and informal • Institutions advised: Government, Parliament and on request municipalities	• Reviews IAs: YES. Quality reviews RIA reports accompanying draft legislation; consultative role to ministries in preparing proposals and drafting RIA reports • Institutions advised: Government	• Reviews IAs: YES. Scrutiny of new regulatory and deregulatory proposals and Post Implementation Reviews (PIR); scrutiny of both Consultation stage and Final Stage IAs • Institutions advised: Government	• Reviews IAs: YES, scrutiny of IAs accompanying new or amended draft regulations • Institutions advised: Government, in a few cases also Parliament
Organisa-tion set-up	Relationship with Govt: independent decision-making body under the umbrella of the Swedish Agency for Economic and Regional Growth (Govt agency)	Relationship with Govt: external, it's not part of a Govt agency	Relationship with Govt: advisory board functioning within the Government Legislative Council, advisory body to the Government	Relationship with Govt: Independent Non-departmental Public Body (NDPB) sponsored by the Department for Business, Energy and Industrial Strategy (BEIS)	Relationship with Govt: The NKR is an independent advisory body. Only regarding organisational issues, the NKR is part of the federal chancellery.
Powers	Advisory role	Advisory role	Advisory role	Advisory role	Advisory role
Transpa-rency	• Opinions on website • annual report	• Annual reports and work programmes • All opinions are published • All ongoing research is announced on the website to allow stakeholders to provide input	Opinions on website	• Opinions on website • Publication of reports and documents on Govt's better regulation agenda • Runs own Twitter feed	• The most important opinions are published on the NKR's website. • All opinions are published together with the government proposal on the website of the council of constituent states (German Bundesrat) • Annual report

	Regelrådet (Sweden)	Actal (Netherlands)	RIAB (Czech Republic)	RPC (United Kingdom)	NKR (Germany)
Composition	• 5 part-time external experts • Background; business, academia or union sectors • Selected and appointed by the government • Mandate: initially 1 year, but probably longer as from next year • Supporting staff: 10 civil servants	• 3 part-time external experts • Background; strong links with business, civil society and politics • Recruited through an open competition, then appointed by government; parliament is informed • Mandate: 4 years renewable twice • Supporting staff: 12 civil servants • Further Advisory board made up of volunteers	• 16 part-time external members • Background: economists and lawyers • Appointed by the Government Legislative Council • Mandate: no limit • Supporting staff: 5 officials	• 8 part-time members (paid on a pro rata basis) • Background: economists, lawyers and representatives from business, civil society and academia • Recruited through open competition • Mandate: at least 2 years • Supporting staff: 15 civil servants	• 10 members on honorary basis • Background: former or current representatives of administration, politics, business, organisations, unions, academia • Members are recommended by the Federal Chancellor and appointed by the Federal President • Mandate: 5 years • Supporting staff: 15 civil servants
Annual No. of opinions issued (2014 or average)	177 (2014)	50 (average)	65 (2014)	500 (average)	300 (average)
Annual budget	€1 million	€2.1 million	n.a.	Almost £1 million	Around €1 million

Annex 7.C

Business Impact Target exclusions

a) Exclusions carried over from last Parliament

- Regulatory provisions that implement new or changed obligations arising from European Union Regulations, Decisions and Directives, and other changes to international commitments and obligations, except in cases of gold-plating.
- Regulatory provisions specifically relating to civil emergencies.
- Regulatory provisions concerning fines and penalties, and redress and restitution.
- Regulatory provisions that promote competition (where these result in an increase in a direct net burden on business).
- Regulatory provisions that enable delivery of large infrastructure projects.
- Regulatory provisions that implement changes to the classification and scheduling of drugs under the Misuse of Drugs Act 1971, or to National Minimum Wage hourly rates, where these follow the recommendations of the relevant independent advisory body.
- Regulatory provisions relating to systemic financial risk.

b) New exclusions applied in this Parliament

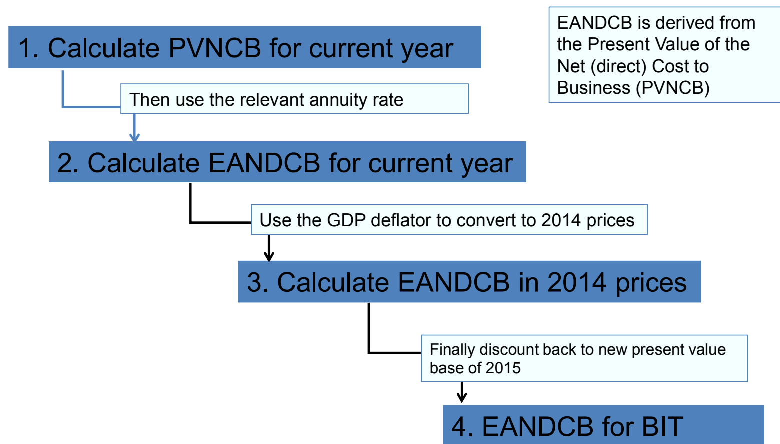
- Regulator casework including specific investigation and enforcement activity, individual licence decisions, and individual advice.
- Education, communications activities, and promotional campaigns by regulators, including media campaigns, posters, factsheets, bulletins, letters, websites, and information / advice help lines.
- Policy development by regulators, including formal and informal consultations, policy reviews, and ad hoc information requests.
- Changes to the organisation and management of regulators, except for those resulting from legislative changes or another policy change that is a qualifying regulatory provision.

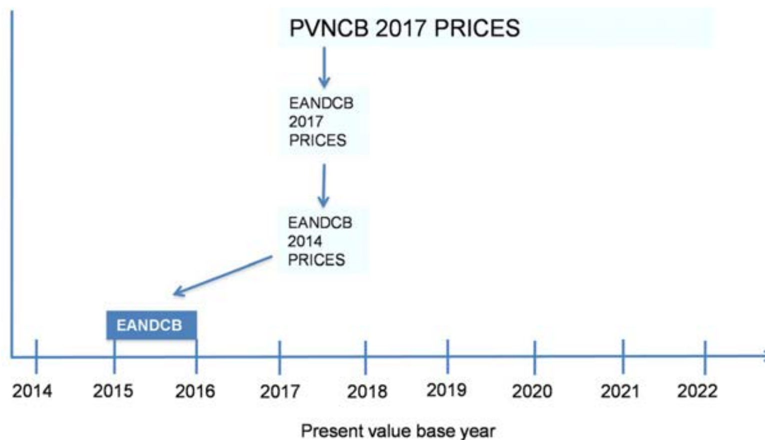
- Regulatory provisions applying to certain business activities of operator(s) of a network or system where the operator(s) are deemed to be a monopoly or to have significant market power, specifically:
  - regulatory provisions that concern the terms upon which access is provided to those networks and systems; and
  - regulatory provisions that concern effective network and systems operation and co-ordination.
- Regulatory provisions that are price controls, except for the introduction of price controls to previously unregulated activities, or removal of pre-existing price controls.
- Changes to Industry Codes, except those arising from regulator action or new legislation.
- Regulatory provisions that introduce the National Living Wage

Source: United Kingdom Parliament (2016).

Annex 7.D

Worked example of calculation of EANDCB





1. Calculate the PVNCB

	2015	2016	2017	2018	2019	2020	2021	Total
t			*1*	*2*	*3*	*4*	*5*	
Discount factor			*1.000*	*0.966*	*0.933*	*0.902*	*0.871*	
Costs			600	25	25	25	25	
Benefits			0	100	100	100	100	
Net Cost			600	-75	-75	-75	-75	
Present Value			600	-72.45	-69.98	-67.65	-65.33	**324.59**

Discount rate (r) = 3.5%	Discount factor = 1/(1+r)^(t-1)

PVNCB(2017) = Sum of PV = **324.59**

In this example we start in 2017 prices and 2017 base year for discounting

2. Calculate the EANDCB

Our actual net costs in each year of the policy were this…

	2015	2016	2017	2018	2019	2020	2021	Total
t			*1*	*2*	*3*	*4*	*5*	
Discount factor			*1.000*	*0.966*	*0.933*	*0.902*	*0.871*	
Net Cost			600	-75	-75	-75	-75	
Present Value			600	-72.45	-69.98	-67.65	-65.33	**324.59**

EANDCB smooths out the fluctuating net costs into a single value (Z) that would give the same NPV…

	2015	2016	2017	2018	2019	2020	2021	Total
t			*1*	*2*	*3*	*4*	*5*	
Discount factor			*1.000*	*0.966*	*0.933*	*0.902*	*0.871*	
Net Cost			Z	Z	Z	Z	Z	
Present Value			1.000*Z	0.966*Z	0.933*Z	0.902*Z	0.871*Z	**324.59**

Solving this for Z…

1.000Z + 0.966Z + 0.993Z + 0.902Z + 0.871Z = 324.59

Or 4.672Z = 324.59

$$Z = \frac{324.59}{4.672}$$

324.59 → **PVNCB**; 4.672 → **Annuity (t=5)**

$$Z = 69.48$$ → **EANDCB**

Using the EANDCB in every year of the policy and summing the discounted stream gives the PVNCB…

	2015	2016	2017	2018	2019	2020	2021	Total
t			*1*	*2*	*3*	*4*	*5*	
Discount factor			*1.000*	*0.966*	*0.933*	*0.902*	*0.871*	
EANDCB			69.48	69.48	69.48	69.48	69.48	
Present Value			69.48	67.12	64.82	62.67	60.52	**324.59**

Had the net cost been 69.48 in each year we would have got the same PVNCB

The annuity rate depends on the appraisal period…

t	Annuity rate
1	1.000
2	1.966
3	2.899
4	3.802
5	**4.673**
6	5.515
7	6.329
8	7.115
9	7.874
10	**8.608**

→ **The example uses t = 5**

→ **t = 10 is the default in IAs**

3. Recalculate the EANDCB to be in 2014 prices

$$EANDCB\,(2014) = \frac{EANDCB\,(2017)}{1.0426} = \frac{69.48}{1.0426} = 66.64$$

GDP Deflator **1.0426**

4. Discount the EANDCB back to new 2015 present value base

$$EANDCB = \frac{EANDCB\,(2014)}{(1+r)^{(2017-2015)}} = \frac{66.64}{1.035^2} = 62.21$$

number of years from 2015 base until start of stream…

… in this example it is two years of additional discounting

The final EANDCB used for the impact assessment is 62.21

Source: Training pack for UK Government economists.

Annex 7.E.

OECD Recommendations on Regulatory Policy and Governance

1. Commit at the highest political level to an explicit whole-of-government policy for regulatory quality. The policy should have clear objectives and frameworks for implementation to ensure that, if regulation is used, the economic, social and environmental benefits justify the costs, the distributional effects are considered and the net benefits are maximised.
2. Adhere to principles of open government, including transparency and participation in the regulatory process to ensure that regulation serves the public interest and is informed by the legitimate needs of those interested in and affected by regulation. This includes providing meaningful opportunities (including online) for the public to contribute to the process of preparing draft regulatory proposals and to the quality of the supporting analysis. Governments should ensure that regulations are comprehensible and clear and that parties can easily understand their rights and obligations.
3. Establish mechanisms and institutions to actively provide oversight of regulatory policy procedures and goals, support and implement regulatory policy, and thereby foster regulatory quality.
4. Integrate Regulatory Impact Assessment (RIA) into the early stages of the policy process for the formulation of new regulatory proposals. Clearly identify policy goals, and evaluate if regulation is necessary and how it can be most effective and efficient in achieving those goals. Consider means other than regulation and identify the tradeoffs of the different approaches analysed to identify the best approach.
5. Conduct systematic programme reviews of the stock of significant regulation against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations remain up to date, cost justified, cost effective and consistent, and deliver the intended policy objectives.
6. Regularly publish reports on the performance of regulatory policy and reform programmes and the public authorities applying the regulations. Such reports should also include information on how regulatory tools such as Regulatory Impact Assessment (RIA), public consultation practices and reviews of existing regulations are functioning in practice.
7. Develop a consistent policy covering the role and functions of regulatory agencies in order to provide greater confidence that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence.

8. Ensure the effectiveness of systems for the review of the legality and procedural fairness of regulations and of decisions made by bodies empowered to issue regulatory sanctions. Ensure that citizens and businesses have access to these systems of review at reasonable cost and receive decisions in a timely manner.
9. As appropriate apply risk assessment, risk management, and risk communication strategies to the design and implementation of regulations to ensure that regulation is targeted and effective. Regulators should assess how regulations will be given effect and should design responsive implementation and enforcement strategies.
10. Where appropriate promote regulatory coherence through co-ordination mechanisms between the supranational, the national and sub-national levels of government. Identify cross-cutting regulatory issues at all levels of government, to promote coherence between regulatory approaches and avoid duplication or conflict of regulations.
11. Foster the development of regulatory management capacity and performance at sub-national levels of government.
12. In developing regulatory measures, give consideration to all relevant international standards and frameworks for co-operation in the same field and, where appropriate, their likely effects on parties outside the jurisdiction.

Source: OECD (2012), *Recommendation of the Council on Regulatory Policy and Governance*, OECD Publishing, Paris, www.oecd.org/gov/regulatory-policy/2012-recommendation.htm.

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