

Regulatory Impact Analysis: an Economist's Perspective

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Introduction

For an economist who was actively involved in public administration in the UK in the 1970s but has worked largely outside the government sector since the early 1980s reading today, in 2003, about the role and scope of regulatory impact analysis or assessment (RIA)¹ in many OECD countries, makes one feel a bit like Rip Van Winkle.

How times have changed! In the 1970s the government economic service was rather small, most administrators were trained in the classics, and cost-benefit analysis was something rather exotic. Today the UK has a Regulatory Impact Unit (RIU) right at the heart of the government in the Cabinet Office which has the task of promoting better regulation and improving the assessment of regulation through the practice and process of regulatory impact analysis.

According to the UK Cabinet Office's "*Better Policy Making: A Guide to Regulatory Impact Assessment*", available on the internet, 'no policy proposal which has an impact on business, charities or voluntary bodies should be considered by Ministers without an RIA being carried out' (p5). Moreover in the same document it is said "an assessment of the benefits and costs is the central analytical component of the RIA. It is the anticipated stream of benefits that flow from regulation or other policy measures that may justify the costs that are imposed on business or other sectors of the economy or society. The purpose of the analysis of benefits and costs is to determine whether these costs are proportionate to the expected benefits" (p 16).

Thus benefit/cost analysis appears to have become a routine part of policy making in areas as diverse as assessing the effects of changing the minimum wage, changing regulations concerning occupational pension schemes, or standardizing with Europe the switch to and from summer time.

In the United States too the systematic use of cost/benefit analysis in the review of regulatory reform has developed since the Carter administration (see the Office of Management and Budget *Report to Congress on the Costs and Benefits of Federal Regulation*, available on the OMB website). By the mid 1990s more than half of OECD countries had adopted some form of RIA and today it is more than two thirds. However, at present RIA is not used by EU institutions, although developments are afoot to introduce it in some form, for example there is a pilot project in progress to improve the EU's Business Impact Assessment system. Evidently, the scope and quality of RIA varies considerably, especially with respect to the use of full-blown benefit/cost analysis across the board. However, in some countries, such as the UK, RIA has clearly created a transformed decision making climate. An important issue is to understand why this remarkable development occurred in the UK and a further important issue is to examine whether the UK practice can be adopted by an accession country such as Latvia. If yes, in what ways should it be modified? And if no, what lessons can nevertheless be drawn.

The development of RIA in the UK

Why is it that the culture of policy-making has shifted so much in the UK since the early 1980s? It is suggested here that two independent developments had a significant impact. Firstly, there was the privatization programme initiated, almost inadvertently by the first Thatcher government. This created a set of rather visible independent utilities regulators. Secondly, just as new forms of regulation developed in response to privatization, public policy in many spheres increasingly appealed to liberal market economics as the basis for efficient policy making. This led to an opposite influence – namely deregulation and the direct promotion of competition as policy instruments. Perhaps too, the increasing technical complexity of many issues led to a growth in the employment of economists in the UK public administration, which in turn influenced the style of policy-making.

The privatization programme

Interestingly, privatization was not in the Conservative Party manifesto for the 1979 general election, rather the Thatcher government hit on it accidentally as a source of government revenue. However, with the privatization of state monopolies such as British Telecom it became apparent that their activities would need to be supervised and it proved to be convenient to do this at arms length from government. Thus independent regulators were created in telecommunications, electricity, gas, water and railways with the task of protecting the interests of consumers in industries that historically had

¹ There seems to be a difference of terminology in this area. For example the OECD talks of Regulatory Impact Analysis while the UK administration refers to Regulatory Impact Assessment. Here the terms will be used interchangeably.

been regarded as "natural monopolies". These agencies complemented traditional economic agencies dealing with competition such as the Monopolies and Mergers Commission or the Office of Fair Trading. In the UK the regulators typically have been individuals backed by a team of professionals rather boards.

The role of liberal economic thinking

The privatization process of course proved to be more than just a useful fiscal instrument for the Thatcher government in the 1980s. Privatization was consistent with the idea that the state should not be directly involved in economic activity and that this was best left for the private sector working within a competitive market economy. The ideas of liberal market economics also suggested that competition rather than regulation *per se* was the more effective instrument to promote the public interest. Thus regulators were charged with the goal of explicitly securing competition as a means of promoting consumer interests. Much effort and ingenuity were devoted to creating competition in areas where previously it was thought impossible eg by providing multiple access to fixed networks, such as in telecommunications, or by creating competitive pricing mechanisms when the number of producers is small as in electricity generation. Such developments also had the effect of making regulation both more technical and more explicitly based on economic analysis. Market mechanisms were even introduced into such unlikely areas as the National Health Service (NHS) where an "internal market" was created. This aimed to mimic the workings of a real market in allocating NHS resources. In short a variety of policy areas were "economised" in the sense of brought within the sphere and under the influence of market inspired economic thinking. Even regulation itself was scrutinized with respect to costs of compliance. The scrutiny of compliance costs of regulatory instruments in turn led to a wider regime of impact assessment under the incoming Blair government in 1997. Indeed it is only under New Labour that RIA has achieved its current status as the essential component of systematic policy making.

How RIA works in the UK

A key aspect of the UK RIA system is that it is regarded as a process rather than as a single document. It represents a series of steps and a series of questions to be answered in any policy proposal submitted by officials. The questions to be addressed are for the most part unashamedly economic. Thus the RIA process contains at least the following elements:

- A clear statement of the objective of the proposal
- A statement of the background to the measure and the current legislative or regulatory framework
- Risk assessment: i.e. an assessment of the scale of the problem to be addressed by the proposed measure
- Identification of options. The RIA should consider the possible alternatives to the proposed policy measure including a "do nothing" option as well as the possibility of achieving the objective without recourse to regulation or legislation
- Cost benefit analysis: identification of sectors affected and where possible benefits and costs should be quantified. Costs should include compliance costs as well as environmental and social costs.
- Impact on small firms
- Impact of each alternative on competition
- Enforcement
- Equity and fairness
- Monitoring: how is the impact of the measure to be measured? Major new regulations have to be reviewed within three years of coming into force.

This is a decision-making structure that is very standard in all kinds of economic decision making problems but here has been adapted to be applied to almost any kind of policy initiative. It would be interesting to see an evaluation of the RIA process in its own terms ie do the benefits exceed the costs?

RIA in the accession countries?

There is a logic to RIA that makes it instinctively appealing to an economist as the basis for a decision making process. Should RIA be practiced in the accession countries? Can it be practiced in the accession countries? If RIA should be adopted, can best practice be simply transferred to the accession countries? What are the lessons to be drawn? These questions are at the core of our conference. In response to the first question the instinctive answer is – yes! Of course RIA should be adopted, it represents a rational decision making process. However, further contemplation raises some doubts: firstly, not all countries are as enthusiastic about RIA as the UK eg France or the EU itself does not at present have an explicit RIA in its decision making procedures. Indeed in the UK guidelines on RIA contained in *Better Policy Making: A Guide to Regulatory Impact Assessment*,

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there is an explicit chapter in dealing with European proposals. The EU creates problems for the UK RIA procedures because proposals are outside the direct control of home policy makers – they come from the Commission and because decisions are ultimately made at the community level which with enlargement will involve 24 other players.

Secondly, there must be serious doubts about the capacity of public administrations in the accession countries to implement the kind of procedures currently used in the UK. There are at least two kinds of potential capacity constraint. One is on the technical capability of existing administrators to carry out the required analysis. Here there could be scope for technical assistance from a country with a developed system of RIA. The other constraint is availability of resources to routinely follow RIA principles in decision making. Here there is some scope for some kind of appraisal of RIA itself.

Another potential barrier to successful adoption of RIA is the general socio-cultural heritage of the Central and Eastern European countries. This comes in at least two parts. One of course the communist heritage and in the case of the Baltic states the explicit Soviet heritage. The second is the “continental” code-based legal systems of the accession countries.

The communist/Soviet legacy has two kinds of effect: firstly, it means that administrators brought up in such a system find many of the central principles of RIA difficult to embrace with genuine enthusiasm. Thus the principles of good regulation which underpin the RIA system in the UK include:

- Transparency
- Accountability
- Consistency
- Proportionality
- Targeting

The first two principles in particular are something that the Soviet system did not offer.

Secondly, there is the danger that the attempt to create a RIA will lead to a procedure that looks like a RIA but is in reality just a smoke screen.

It is noticeable that RIA appears to have been developed and taken root in the common-law countries ie US, UK, and Australia, and that it developed later and in a more modest form in countries such as France or Germany which have very different legal systems from the common law countries. Quite why this should be the case is not clear – perhaps something about the code-based legal system which makes it less flexible than is required for RIA. Ie there is a presumption *in favour* of regulation rather than against as is the case in the UK RIA. This could be an area for research.

The RIA system in Latvia

Remarkably perhaps Latvia has a system of RIA. The State Chancellery of the Cabinet of Ministers is charged with the responsibility checking both the drafting of laws and with providing an “anotacija”. This literally translates as an annotation but is in reality is a regulatory impact analysis. The instructions for carrying this out look very similar to the UK guidelines, with a requirement to outline the current situation, to explain the objective of the proposal, to consider whether the proposal will address current problems. The assessment is then required to provide an evaluation of the impact on the economy, the budget (central and local) and on a variety of economic and social groups.

In practice only a few of the proposals published on the web site of the State Chancellery include an assessment. Moreover, perusal of these indicates that none of them contains a full cost/benefit analysis, though many contain detailed calculations of the impact of the proposed measure on state and local budgets.

Concluding remarks

The 1999 evaluation of Phare programmes in support of European Integration and Law Approximation concluded that “capacities for regulatory impact assessment have ... not been given adequate attention” and recommended that “development of ...regulatory impact capacities should be prioritized”. Similarly, Sir Robin Mountfield in a year 2000 report on Public Administration Reform in Latvia recommended the creation of a “New Chancellery” which contained “a small group checking ‘regulatory impact’, that is checking in advance that intended laws and policies would actually achieve the desired results”.

It seems that in some measure Latvia has actually achieved this.

References

[1] Regulatory Impact Unit, UK Cabinet Office: *Better Policy Making : A Guide to Regulatory Impact Assessment* <http://www.cabinet-office.gov.uk/regulation/>