

Good Practice Guide on Regulatory Reform

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Executive Summary

The Good Practice Guide on Regulatory Reform (the Good Practice Guide) was prepared by the Economic Committee, and will assist member economies to design and improve their own regulatory architecture which allows them to systematically deal with the flow and stock of regulations. Strong regulatory architecture will ensure regulations are effective and efficient.

The framework allows the potential, or actual, impact of new and existing regulation to be systematically identified, measured and considered by decision-makers. The impact of proposed and amended regulation (often referred to as the 'flow' of regulation) is analysed using processes such as Regulatory Impact Analysis. The effectiveness and efficiency of existing regulation (often referred to as the 'stock' of regulation) is addressed through ongoing scrutiny and review processes.

The purpose of the Good Practice Guide is to help APEC economies to develop good regulatory systems which produce good regulatory outcomes. Its six chapters provide an overview of key aspects of regulatory frameworks.

Designing regulation-making and review systems and processes

- This chapter explores the design of regulation-making and review systems and processes available to economies. It includes an example from Australia.

Role of regulatory institutions in best practice regulatory reform

- This chapter discusses the types of regulatory institutions available, where they may be situated in government administration and functions that they may perform. It includes examples from the United States of America and Hong Kong, China.

Regulation Impact Assessment

- This chapter explains what RIA is, how it can be used and its methodology. It also discusses when to undertake RIA and quality control issues. It includes examples from Mexico, Australia and New Zealand.

Consultation mechanism

- This chapter considers how consultation can be used as a tool to assure systematic quality in regulation decision-making. It includes examples from Mexico and Peru.

Enforcement and administration of regulation

- This chapter provides guidance on factors that usefully can be taken into account when developing enforcement strategies and implementing them. It includes an example from New Zealand.

Alternatives to regulation

- This chapter discusses the three broad categories of alternatives to prescriptive regulations and explains how APEC and OECD checklists can be used to consider alternatives at an early stage of the regulatory process. It includes examples from Australia, Hong Kong, China and Korea.

Designing regulation-making and review systems and processes

Introduction

1. Regulation is an integral part of a well-functioning economy and can be used to achieve desired economic, social and environmental objectives. The task for governments and regulation-makers is to strike a balance between the need for regulation, based on the potential harm being addressed, and the cost that regulation would impose. Regulation-making and review systems and processes provide a framework to assist in undertaking this task.

2. Increasingly, APEC economies are formalising government consideration of this trade-off by developing processes for the systematic analysis of new and existing regulation. This is consistent with the *APEC Principles to Enhance Competition and Regulatory Reform*, endorsed by APEC economies in September 1999.

3. Regulation-making and review systems and processes are the means by which governments can implement a regulatory reform policy. The idea that a permanent regulatory reform policy is necessary to ensure that the quality of the 'stock' of existing regulation is maintained and that there are quality controls over the 'flow' of new regulation is now widely accepted as a necessary complement to ad hoc 'de-regulation' agendas.

4. A regulatory reform policy should have clear objectives. However, the content and emphases of the objectives will vary, reflecting differences in domestic needs and priorities. A non-exhaustive list of common objectives underlying regulatory reform policies includes:

- increasing social welfare by better balancing and more effectively delivering government policies over time;
- boosting economic development and consumer welfare by encouraging market entry, innovation and competition and thereby promoting competitiveness;
- controlling regulatory costs so as to improve productive efficiency by reducing unnecessary costs (in particular for small and medium sized businesses);
- improving public sector efficiency, responsiveness, and effectiveness through public management reforms;
- rationalising and simplifying the law; and

- improving the rule of law and democracy through legal reform, including improved access to regulation and reduction of excessive discretion of regulators and enforcers.
5. Regulatory reform policy programs typically begin with a focus on one or more of the above objectives and broaden their concerns over time as experience accumulates to the broadest possible objective (that of enhancing net social welfare).

Good practice guidance — principles and processes

Designing regulation-making and review systems and processes

6. The diversity of policy approaches to regulation reform means that there is no single design template for regulation-making and review systems that will be effective in all situations. That said, well-designed regulation-making and review systems and processes should:

- be capable of building political awareness and support for regulatory reform;
- promote the objectives and content of a regulatory reform policy, including principles of good regulation and supporting institutions, within government and the public service;
- integrate various regulatory tools (such as regulatory impact analysis (RIA)) into an economy's existing policy-making systems and processes, to ensure that the impacts of regulation are identified, analysed and communicated with influence to policy-makers; and
- apply regulatory tools to enhance the efficiency and effectiveness of both the flow of new regulation and the stock of existing regulation.

7. The regulatory reform policy adopted by government should establish principles of regulatory decision-making, which are applicable when making, or reviewing, regulation (that is applied to both the stock and flow of regulation). These principles should guide the design of regulation-making and review systems and processes.

8. The following principles for regulation-making have been widely accepted as good practice. These principles are intended to be broad and easily applicable to any economy and any policy issue.

8.1. *Clearly define the problem.* The problem should be precisely stated, giving evidence of its nature and magnitude, and explaining why it has arisen.

8.2. *Justify government action.* Government intervention should be based on explicit evidence that government action is justified given the nature of the problem, the likely benefits and costs of action (based on a realistic assessment of government effectiveness), and alternative mechanisms for addressing the problem. There are two conventional reasons for regulatory intervention:

8.2.1. that in important instances and left to its own devices, the market will fail to deliver an outcome which benefits the community as a whole (market failure). Some examples include: taxes levied on producers

to correct for pollution externalities, regulation of oligopolies/cartel behaviour, direct provision of public goods such as defence, policies to introduce competition into markets and price controls for recently privatised utilities; and

- 8.2.2. that social concerns, such as equity or health and safety, require action by governments to protect groups in the community. One example is the reduction of inequality of income as well as wealth distribution through the regulation of the tax system and specific policies such as the minimum wage.
- 8.3. *Consider a range of policy options (including alternatives to regulation).* Regulation-makers should carry out an informed comparison of a variety of regulatory and non-regulatory policy instruments to address the problem, considering relevant issues such as costs, benefits, distributional effects and administrative arrangements.
- 8.4. *Weigh the benefits and costs of the regulation.* Regulation-makers should estimate the total expected benefits and costs of each regulatory proposal and of feasible alternatives, and should make the estimates available in an accessible format to decision-makers. The costs of government action should be justified by the benefits before action is taken.
- 8.5. *Consult with interested parties.* Regulations should be developed in an open and transparent fashion, with appropriate procedures for effective and timely input from interested parties such as affected businesses and trade unions, other interest groups, or other levels of government.
- 8.6. *Consider enforcement and incentives for compliance.* Regulation-makers should assess the incentives and institutions through which the regulation will take effect, and should design responsive implementation strategies that make the best use of them.
- 8.7. *Review mechanisms to ensure the continuing effectiveness of the regulation.* Mechanisms should be introduced to ensure that the regulation remains relevant and effective over time. These should encompass removing regulation made redundant by changing conditions, or amending regulation to reflect new circumstances.

Improving the quality of new regulations (flow) and existing regulations (stock)

9. The quality control of the flow and stock of regulations is important because it allows governments to eliminate barriers or restrictions to trade, innovation, investment and economic efficiency. This is especially true if it takes place within a regulatory reform policy that aims to achieve sustainable economic growth through the construction of a transparent and clear regulatory framework.

10. However, even with good regulation-making processes, problems with regulation inevitably emerge over time due in part to the growth in the stock of regulation and the cumulative burden it generates.

11. Other problems can occur from the ongoing relevance and effectiveness of particular regulations after they are implemented. Market, technological and environmental circumstances are subject to change, and can do so sometimes quite

substantially and in relatively short periods of time. This may make existing regulations redundant or mean they require considerable modification to continue to be effective.

12. Regulatory Impact Analysis (RIA) is a term used to describe the process of systematically analysing and communicating the impacts of new and existing regulations. The essential characteristic of RIA is the process through which regulatory interventions are systematically and coherently assessed in order to improve regulatory outputs and decision-making, starting as early in the policy-making process as possible. RIA can be used to assess the impacts of new regulation and amended (flow) as well as existing regulation (stock).

Reviewing and updating regulations

13. The diversity of policy approaches to regulation review systems and procedures means that there are a variety of approaches that regulation review processes can consist of and be used in different situations. OECD experience and recommendations focus on the following aspects of regulation review. There are a number of commonly applied review processes used amongst economies.

Ad hoc or sector-specific reviews

14. Most economies carry out some form of partial review of existing regulations on an ad hoc basis. However, very few do this systematically or periodically. To produce real change, comprehensive review and the rebuilding of entire regulatory regimes is often necessary. This process is referred to as 'scrap and build' in Japan and 'reinventing regulation' in the United States.

15. Such reviews may examine the stock of regulation from a variety of perspectives depending on the purpose of the review. Comprehensive analysis of regulation is ensured through the use of RIA methodology since it focuses on:

- a particular policy objective;
- the impact of regulation on a particular group; and
- a particular sector or industry.

16. External independent advisory bodies can play an important role in conducting ad hoc or sector specific reviews. Such institutions can provide expert analysis of particular sectors or areas of regulation (informed by extensive public consultation), and deliver credible advice and recommendations for reform that can be readily adopted by governments.

Automatic mechanisms for review

17. Review clauses, or sunset provisions, provide a more systematic approach to monitoring of regulatory performance. Review clauses are requirements contained within regulations themselves for reviews to be conducted within a certain period. They can act as a powerful addition to initial decision-making RIA by checking the performance of regulations against initial assumptions. Also, they ensure that the continued appropriateness of regulations is measured against current circumstances and new regulatory (and non-regulatory) options. The effectiveness of automatic review

mechanisms is enhanced where the central oversight body has a role in monitoring the operation of review clauses and compliance with the requirements.

18. An example of a review clauses concerns Japan, where there is a requirement that a fixed schedule for future reviews be included in new regulations. Much of Japan's regulation already incorporates requirements for ex-post review after a fixed period of time (ranging from approximately three to ten years after introduction).

Practical steps and tips to implement good practice

19. The framework for producing new and amended regulation should encourage quality policy decision-making based on accurate analysis of the impact of proposed regulation, which is communicated effectively to decision-makers. The goal of this framework is to ensure that regulation is introduced only where there is a need for government action and where the superiority of the preferred option has been demonstrated transparently.

20. For existing regulation the framework should provide for scrutiny and review of the effectiveness and efficiency of regulation over time. An ongoing program of review of regulation assists in:

- identifying specific areas of regulation which are unnecessarily burdensome, complex, redundant or duplicative;
- indicating the areas in which regulation should be removed or significantly reduced as a matter of priority;
- examining non-regulatory options (including self regulation) for achieving desired outcomes and how best to reduce duplication and increase harmonisation within existing regulatory frameworks; and
- providing options to improve the effectiveness and efficiency of regulation.

21. The specific processes and institutions that are put in place may not remain appropriate over time as the needs and expectations of the economy in which they operate change. Rigorous evaluation of systems and processes can identify the aspects of the regulation-making systems and processes that need to be amended.

22. The purpose of the evaluation of regulatory policies is to improve the performance of regulatory quality tools and institutions — measured in terms of their ultimate goal of increasing the effectiveness and efficiency of regulation over time. Thus, the evaluation is based on improving the performance of government and its accountability for that performance to its citizens. Developing a sound understanding of the practical performance of regulatory systems and processes through rigorous evaluation can assist policy-makers in making the case for continuing to devote resources and effort to these ends and provide the basis for further entrenching regulatory policy within the core of government.

23. The OECD has developed guidance for ways in which the regulation reform processes and institutions can be assessed. The OECD has defined three broad categories of tests that can assist in evaluation of regulation-making systems and processes.

- **Compliance tests** evaluate formal compliance with the procedural requirements of the regulatory system, as set out in laws, policies or guidelines as appropriate.
- **Performance tests** measure the quality of the analysis undertaken, going beyond the question of formal compliance with procedural requirements.
- **Function tests** evaluate the actual effect of the regulatory system on the quality of the regulatory outcome.

24. The OECD recommends that there should be a correlation between the kinds of tests employed and the sophistication/experience of the regulatory framework in the economy. Relatively simple compliance tests should be favoured in the early stages of implementation of a regulatory system. Performance tests should increasingly be favoured as expertise in the application of the tests is developed and where there is a greater concern with the quality of their application. Outcome tests should be used to test whether a fully functioning regulatory system is in fact having the predicted effects in increasing regulatory quality.

APEC economies' experiences

25. Regulation-making and review systems and processes evolve over time as the needs of the community in which they operate change and as understanding of the use of these tools increases.

Australia's regulation-making and review systems

26. Australia revised its regulation-making and review systems during 2006 and 2007, in response to a wide-ranging review of regulatory burdens imposed by the Australian Government. The review was undertaken by an independent panel chaired by the Chairman of Australia's Productivity Commission.

27. The key elements of the revisions to Australia's regulation-making and review systems, which apply to all regulation, include the following.

- The appointment of a Minister for Business Deregulation to champion regulatory reform.
- More rigorous regulatory impact assessment (RIA) of regulatory proposals via a three-tier system.
 - All proposals must undergo a qualitative preliminary 'self-assessment' (undertaken by the regulation-maker) to identify any compliance, competition or other significant impacts.
 - If medium compliance costs are identified, a quantitative assessment must be documented.
 - If there is a significant compliance cost or other impact on business and individuals or the economy, a detailed cost-benefit and risk analysis must be completed.

- Establishment of the Office of Best Practice Regulation (OBPR — formally the Office of Regulation Review) to assist regulation-makers to undertake RIA. The OBPR also monitors and reports publicly on the Government's compliance.
- Gate-keeping arrangements have been strengthened to enforce compliance with the RIA requirements for all regulatory proposals considered by the federal Cabinet, Australia's principal regulation-making authority.
- Adoption of a whole-of-government policy on consultation, which sets out Good practice principles that must be followed by all regulation-makers when developing regulation.
 - A business consultation website also has been established as a one stop shop for businesses, associations and other interested parties to receive information about proposed changes to regulation.
- A mandatory screening process for reviews of regulation, five years after implementation.
- The Australian Government is implementing the 2007 election commitment to apply a one-in-one-out principle whereby when Ministers bring forward proposals that have regulatory impacts they are required to identify regulations or processes that may be removed and to provide an assessment of the net impact. The principle is intended to apply a discipline of regulatory budgeting to the decision-making process and is a key tool in achieving the Government's commitment to 'no net increase' in the regulatory burden.

28. On 28 February 2007, the Australian Government requested its independent policy advisory body, the Productivity Commission, to conduct ongoing annual reviews of the burden on business arising from the stock of government regulation. Following consultation with business, government agencies and community groups, the Commission is to report on those areas in which the regulatory burden on business should be removed or significantly reduced as a matter of priority and options for doing so.

29. The Commission is to review all Australian Government regulation cyclically every five years. The cycle commenced with a review of regulatory burdens on businesses in Australia's primary sector, reporting in October 2007. In August 2008, the Commission will report on the manufacturing sector and distributive trades. In subsequent years, the Commission will report sequentially on social and economic infrastructure services, and business and consumer services. The fifth year is to be reserved for a review of economy-wide generic regulation, and regulation that has not been picked up earlier in the cycle.

References and further information

- APEC-OECD Integrated Checklist for Regulatory Reform
- OECD Guiding Principles for Regulatory Quality and Performance (2006)
- Office of Best Practice Regulation (Australia)
 - Best Practice Regulation Handbook (2007)

Role of regulatory institutions in good practice regulatory reform

Introduction

30. Regulatory reform refers to changes that improve regulatory quality to enhance the economic performance, cost-effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform.

31. Regulatory reform maximises the efficiency, effectiveness, transparency and accountability of regulation, by creating a framework through which the potential or actual impact of regulation can systematically be identified, measured and considered by regulation-makers. Regulatory reform does not aim to remove all of the costs of regulation — rather, it seeks to address unnecessary costs arising as a result of:

- poor quality regulation (regulation that exacerbates the problem it is attempting to correct, and may create new and more serious problems that did not exist before); and
- excessive regulation (regulation which achieves the intended policy goal, but not through the lowest cost method).

32. Addressing the unnecessary costs of regulation will ensure that stakeholders can effectively manage risk and operate in a pro-competitive environment, prompting businesses to allocate resources to their most valued use, to innovate and to seek more efficient techniques over time. This boosts productivity, underpinning stronger, more sustainable economic growth and enhancing living standards and wellbeing.

33. Regulatory institutions usually are established as part of the executive or legislative bodies or (more rarely) have an independent status. In a broad sense, they have a remit to bring a strategic and 'whole-of-government' perspective to bear on the processes associated with employing the regulation-making tools of government.

Good practice guide — principles and processes

34. Regulatory institutions must be designed in the context of the political, economic and social environment in which they are to operate. They may take a variety of forms and each economy may have a number of institutions with each performing a niche role.

35. The key institution is the regulatory oversight body, often located at the centre of the government administration, with a broad remit to build consensus on regulatory policy, assist regulators in implementation, undertake quality control (for example, through regulatory impact analysis) and report on overall performance in achieving regulatory policy objectives. Other institutions, including the executive and legislative decision-making bodies, regulators and advisory bodies form part of the institutional arrangements for regulation.

36. The OECD has defined some key characteristics of these regulatory institutions, based on observation of these bodies in practice.

Central oversight bodies

37. A central oversight body may be created to perform some, or all, of the following key roles.

- The **advisory role** involves providing advice and support to regulation-makers to assist them in complying with government policies aimed at regulatory quality assurance. This can involve the publication and dissemination of written guidance and the provision of training on topics such as aspects of the regulatory impact analysis (RIA) processes and techniques (refer to chapter 3 for more on RIA). It may also involve a more specific, 'hands on' approach, whereby the central unit provides advice to regulators in the context of their development of particular regulations.
- The **gatekeeper** role involves challenging and controlling the quality of draft regulations. This function centres on the ability of the oversight body to question the technical quality of RIA and the underlying regulatory proposals, and is likely to be based on compliance with a 'checklist'. The gatekeeper function also may involve checking and enforcing compliance with procedural requirements, such as aspects of the consultation process.
- The **advocacy role** involves the promotion of long-term regulatory reform policy goals, including policy change, the development of new and improved tools and institutional change. This role sees the oversight body as an active player in the policy formulation process. Sometimes this advocacy role is undertaken by an external body appointed by government, such as the Council for Regulatory Reform in Japan.

38. Institutions responsible for central regulatory oversight vary widely in function and design. However, the oversight body is likely to be most effective when associated with the centre of government, where authorities for inter-agency oversight are already well-established. In some economies, a specialist body has been established with responsibility for overseeing RIA programs. Other economies have located an oversight unit within the industry, commerce or economics bodies, budget and general public sector management bodies, or at the centre of government (for example, cabinet offices).

Other supporting institutions

39. In addition to central oversight bodies, various other institutions may play an important role in promoting and implementing regulatory reform policies, processes and systems.

Executive or key policy decision-making body (for example, Cabinet)

40. The executive body is a key source of regulation in two ways: in terms of proposing new laws to parliament, and in terms of establishing secondary rules to give effect to primary legislation. Consequently, the executive body's endorsement of regulatory reform policies and acknowledgement of the value of RIA in developing policy is essential.

Legislative

41. Parliaments have formal responsibility for reviewing and enacting primary legislation, which is why it is important they are integrated into regulatory quality systems and processes. Parliament's ability to scrutinise legislation should be aligned with the regulatory quality procedures adopted in the executive — they should be mutually reinforcing. The information obtained through RIA must be taken into account. As parliaments realise the importance of RIA, they can provide invaluable support for its use.

Independent regulators

42. Independent regulators are public bodies charged with regulating specific aspects of an industry. The role of independent regulators tends to be concerned with enforcing rules and dispensing penalties for non-compliance, or authorising the issue of licences and permits. Independent regulators contribute to improving regulatory quality, transparency, stability and expertise. When such regulators are responsible for making rules or interpreting them, they should operate under the same disciplines as other rule-makers, including requirements for RIA.

Independent, external advisory bodies

43. Independent entities external to government may be established with power to provide official and expert advice to government on specific regulations and aspects of an economy. This may include external committees, advisory bodies, think tanks or research bodies made up of a majority of non-governmental representatives such as academia and business organisations. These bodies may be established on an ad hoc basis to respond to specific regulatory issues, or alternately, may have an ongoing role in identifying priorities and proposing reforms.

Practical steps and tips to implement good practice

44. It is essential that regulatory reform has the support of government at the highest political level, recognising that the key elements of regulatory reform — policies, tools, institutions — should be considered as a whole, and applied at all levels of government.

45. Demonstrated high-level political support for regulation reform — through legislation, government decrees or statements — serves several important purposes in implementing, sustaining and deepening regulatory quality reforms, including:

- signalling the government's commitment to reform the regulatory environment across the whole of government. This helps to lend authority to the institutions through which regulatory reform is possible and to provide incentives to achieve regulatory objectives and goals, which should help to overcome opposition and bureaucratic and political inertia;
- establishing clear policy objectives and the means for meeting them, which can assist in developing a systematic and permanent process. It assists in establishing accountability for government officials' use of regulatory powers. It also increases the centre of government's powers to implement the policy, and reduces the ability of vested interests to block reform;

- enhancing the effectiveness of coordination and cooperation efforts by establishing a general framework. This helps to ensure coherence and comprehensiveness in reforming the regulatory environment across policy areas;
- authorising and mobilising action in the administration. This helps to assist in overcoming civil servants' hesitation in pursuing reform against vocal interest groups;
- enhancing the credibility and transparency of reform, by clarifying the relevance of regulatory reform to larger social and economic goals; and
- making transparent the government's objectives and the strategies of its reform program, and therefore, creating accountability for outcomes — both between government and citizens, and regulators and government.

46. Effective and credible mechanisms inside government are needed to manage and coordinate regulation and its reform. Regulatory reform policy needs to find its place in an economy's legal and institutional architecture, which is a major challenge for governments. Because the context in which governments work to improve regulatory quality is complex and remains fragmented, some form of central mechanism is needed that goes beyond the simple coordination of existing bodies scattered across government areas.

47. A common characteristic of economies that have implemented regulatory reform policy is that the ministry or regulation-makers have the primary responsibility for creating quality regulation and reform. That is where the expertise lies, and where policies are formulated. Yet it is often difficult for regulation-makers to reform themselves or to integrate new quality disciplines, given countervailing pressures. As a result, most governments have established central regulatory coordination and management capacities headed by ministers with whole-of-government responsibility for regulatory reform policy.

APEC economies' experiences

48. The United States and Hong Kong, China are examples of economies that have established oversight bodies at the centre of their regulatory institutions.

United States

49. In the United States, responsibility for review and coordination of Federal regulations is centralised within the Office of Management and Budget (OMB). The scope of OMB's regulatory oversight is broad, covering agriculture, energy, transportation, information technology, housing, manufacturing, immigration, food safety, health care, public health, occupational safety and health, environmental protection and criminal justice.

50. Within OMB, the Office of Information and Regulatory Affairs (OIRA) has responsibility for reviewing draft regulations. The Executive Order directs agencies to follow certain principles in rulemaking, including consideration of alternatives to the rulemaking and analysis of the rule's effects on society, both its benefits and costs. The OMB also issues guidance to regulators on regulatory analysis and the assessment of costs and benefits. OMB developed its guidance in collaboration with the President's

Council of Economic Advisors, and revised the proposed guidelines based on public comments, peer review, and interagency review.

51. OIRA's review of agency draft regulations ensures that agencies comply with key regulatory principles and that agency rules reflect the President's policies. OIRA also serves to ensure adequate interagency review of draft rules, so that draft rules are coordinated with relevant agencies to avoid inconsistent, incompatible or duplicative policies.

Hong Kong, China

52. A different approach is taken in Hong Kong, China, where the Business Facilitation Advisory Committee (BFAC), together with the Economic Analysis and Business Facilitation Unit (EABFU) and the sector-specific task forces, function as a quality control mechanism to varying degrees. The BFAC advises and reports to the Financial Secretary on the development and implementation of programs and measures to facilitate business. This serves as a channel for the senior management of the government to monitor regulatory reform progress.

53. Moreover, the BFAC sets the priority for conducting regulatory review of selected sectors and sets up dedicated sector-specific task forces to carry out the review. The task forces usually invite the relevant industry stakeholders to take part in the review.

54. The EABFU, under the direction of the BFAC, conducts regulatory reviews on those sectors not covered by the task forces and coordinates with concerned departments/bureaux in taking forward business facilitation initiatives endorsed by the BFAC. The EABFU also works closely with departments/bureaux in conducting Regulatory Impact Assessments.

References and further information

- OECD Indicators of Regulatory Management Systems and Quality
- APEC Individual Action Plans

Regulation Impact Assessment

Introduction

55. Regulation Impact Assessment (RIA) is the term used to describe a process of systematically analysing and communicating to regulation-makers and regulated entities the impacts of regulations. RIA can be used to assess the impacts of new regulation and amendments to regulation (often referred to as the 'flow' of regulation) as well as existing regulation (the 'stock' of regulation). RIA may examine impacts on business, the environment, administrative/paperwork burdens, or any other impact that is of relevance to the regulation-maker.

56. RIA can only be effective when embedded within an economy's broader policy-making framework. The policy decision-making methods used in each economy will differ according to domestic culture, political traditions, administrative style and the issue at hand, but can be simplified into the following five categories.

- *Expert:* the decision or decisions are reached by a trusted expert, either a regulation-maker or an outside expert, who uses professional judgement to decide what should be done.
- *Consensus:* decision is reached by a group of stakeholders who reach a common position that balances their competing interests.
- *Political:* decision is reached by political representatives based on partisan issues of importance to the political process.
- *Benchmarking:* decision is made through reliance on an outside model, such as international regulation.
- *Empirical:* decision is based on fact-finding and analysis that defines the parameters of action according to established criteria.

57. In essence, RIA attempts to clarify the relevant factors for regulation-making under each of these methods. It pushes regulators towards making balanced decisions that trade-off possible solutions (including the decision to do nothing) to specific problems against wider economic and distributional goals. RIA's most important contribution to the quality of decisions is not the precision of the calculations used, but the action of analysing — questioning, understanding real-world impacts, exploring assumptions.

Good practice guidance — principles and processes

58. There is no single system for the implementation of RIA that is desirable in all economies at all times. Institutional, social, cultural, legal and developmental differences between economies require different system designs. As regulation-makers gain experience and expertise in RIA, these systems will evolve and continually improve. However, the following elements of good practice serve as starting points for the design of a system likely to maximise the benefits of RIA.

- Commence RIA at the earliest feasible stage in the policy development process.

- Provision should be made for screening regulatory proposals to determine which proposals require RIA and the type of assessment to be undertaken.
- RIA should be documented and made available for public comment and review.
- The RIA report should be used in the regulation approval process.
- RIA should inform monitoring, evaluation and post-auditing processes to ensure that regulation does not have unintended effects.

59. A key strength of RIA as a tool to assist in informing regulation-making is its ability to expose the merits of decisions and the impacts of actions. For this reason, to the extent practicable, RIA should be linked to processes of public consultation. In practice, economies might find it useful to build consultation around RIA documents that state the goal and effects of proposed rules (refer to chapter 4 for more on consultation).

Incorporating competition assessments in RIA

60. The importance of considering the impacts of regulation on competition is articulated in the APEC *Principles to Enhance Competition and Regulatory Reform*.

61. In a practical sense, it is important that all regulators, including those that do not have a primarily economic focus (and therefore lack expertise) share a common understanding of the potential competition impacts of regulation that they design and implement. The OECD has developed a Competition Assessment Toolkit, which provides a clear framework within which regulators can consider competition impacts. The Competition Assessment Toolkit divides competition issues into three broad questions, each of which can be broken down into a more detailed set of questions.

- Would the regulatory proposal affect the number and range of suppliers?
- Would the regulatory proposal affect the ability of suppliers to compete?
- Would the regulatory proposal alter suppliers' incentives to compete vigorously?

62. These questions easily can be incorporated into an RIA process. For example, a modified version of these questions has been incorporated into the Australian Government's guidance to regulation-making agencies on RIA requirements for all new regulations that affect business.

Practical steps and tips to implement good practice

63. Although there is no single model of RIA that is applicable to all economies at all times, there are several key aspects that must be present in some form or other in a robust RIA system including: the choice of technical methodology; decisions about when to undertake RIA; and quality control mechanisms.

RIA methodology

64. The methodology used to analyse the impact of proposed or existing regulation should be flexible and relevant to the particular circumstances of the individual economy. As a general principle, RIA should require the use of the benefit-cost principle for all

regulatory decisions (that is that the benefits outweigh the costs), but the form of analysis employed should be based on practical judgements about feasibility and cost.

65. There are five main analytical methods used in RIA programs.

- **Cost-benefit analysis:** quantifies and evaluates the costs and benefits of a regulatory intervention in terms of the public's willingness to pay for them (benefits) or willingness to pay to avoid them (costs). Inputs are typically measured in terms of opportunity costs which is the value in their best alternative use. The guiding principle is to list all of the parties affected by an intervention, and place a monetary value of the effect it has on their welfare (as it would be valued by them).
- **Multi-Criteria Analysis (MCA):** systematic comparison of the impact of different alternative policy responses in circumstances in which major impacts are identified, but not able to be quantified. MCA involves the identification of the objectives behind a policy proposal as well as criteria which would indicate the achievement of those objectives. The various policy options are then compared to determine which best meets the criteria identified and therefore are most likely to achieve the overall objectives.
- **Cost-effectiveness analysis:** comparison of alternatives to find lowest cost solutions that produce specific outcomes. This method is limited, as it does not determine if the action is worth taking (that benefits outweigh costs) and does not resolve the choice of optimal level of benefits. However, it can help to select the lowest cost regulatory option.
- **Partial analyses:** analyses particular types of costs (compliance costs, fiscal or budget costs, administrative costs, competition impacts, environmental impacts) or the particular impacts of regulation on specified groups (small business, families, consumers). This method recognises that different impacts have different weights, and the decision to weigh some impacts more heavily than others is mainly a political decision based on policy priorities and values. However, this method carries a high risk of incorrect policy conclusions because it does not provide the full, undistorted picture of the consequences of actions.
- **Risk assessment:** attempts to quantify the risks (involving consideration of the hazards and consequences) to enable rational judgement to be made as to whether government action is justified. This method is useful in answering the threshold question of whether to regulate, and contributes to policy choices about the desirable degree of risk reduction. Complications in its use derive from observed variation between real and perceived risk, or between society's acceptance of different kinds of risks.
- **Sensitivity or uncertainty analysis:** projects the likelihood of a range of possible outcomes due to estimation errors, to provide policymakers with a more accurate understanding of the likelihood of impacts. Sensitivity analysis should be used as a technique to refine the expected future benefits and costs.

66. Cost-benefit analysis is the most comprehensive RIA method, enabling comparison of quantified costs and benefits over time, based on the underlying principle that any decision about government action should be justified by the benefits. However, there are practical difficulties associated with the implementation of strict cost-benefit analysis, in particular data availability.

67. MCA is a methodological approach that potentially can assist in better integrating quantitative and qualitative analyses and so enhance the ability of RIA to provide relevant and useful guidance to policy-makers where the major variables have not been able to be expressed in monetary terms. The key advantages of MCA are that it allows distributional issues and trade-offs to be highlighted, by ensuring that key criteria used to assess regulatory proposals and alternatives are transparent.

Timing

68. It is not cost-effective or resource-efficient to undertake an in-depth RIA for all regulation. RIA is potentially resource-intensive and must be targeted to ensure scarce RIA resources are applied where they can do the most good. This implies three possible strategies.

- **Wide application of RIA.** Wide application of RIA is desirable, with light-handed RIA applied to more regulatory proposals. However, it may be necessary to limit the scope of RIA application, particularly in the early stages of implementation, where it may be practical to proceed on a step-by-step basis, extending the scope of RIA provisions as assessment experience and capacities expand. A number of criteria may be applied to limit the application of RIA, including:
 - level of administration (that is federal, regional, local government regulation);
 - level of regulation (that is primary and/or secondary instruments — for example, primary legislation and/or subordinate legislation);
 - type of measure (that is rules, financial instruments, policies); and
 - type of impact (that is environmental, social, economic, competitive) or sectors to which the measures applies (business, small business).
- **Targeted application of RIA resources.** RIA thresholds, below which the impact of regulation is so small that the likely benefits of RIA are insufficient, enable RIA to be effectively targeted. The determination of appropriate trigger thresholds can be difficult and it may be useful to establish different objective thresholds for different categories of regulations or use subjective thresholds like ‘major’ or ‘significant’ impacts.
- **Proportionate level of analysis.** Where RIA is undertaken, the level and depth of analysis should be proportionate to the impact of the regulation.

Oversight and quality control

69. Quality control is necessary if RIA is to be carried out with a reliable level of consistency and quality. There are a number of strategies an economy may employ to increase oversight and quality control of RIA.

- *Strengthening the challenge function of a central RIA oversight body.* Locating the institution overseeing compliance with RIA policies at the centre of government should ensure the unit has the competency, standing and prestige to influence ministers and regulation-makers and effectively challenge RIA quality.
- *Involvement in RIA quality control and monitoring by other institutions.* The central quality control unit must be supported by a network of institutions, including

political level bodies and inter-ministerial working groups close to government, or private sector groups and advisory bodies that can identify priorities and propose reforms.

- *Early timing and preparation of RIA to permit more discussion.* This could include the use of annual regulatory planning to provide early notice to the public about regulatory initiatives at a time when it is still possible to fundamentally influence the regulatory decision. The practice of requiring an early screening RIA is one that governments should consider to support both a policy for proportional analysis and to open the way for earlier and more meaningful public consultation on the alternatives and regulatory design.
- *Monitoring and reporting of RIA quality by central institutions followed by public reporting of performance (or name and shame).* The regular assessment and publication of performance data in relation to RIA compliance would not only increase confidence in the achievement of standards and therefore RIA's contribution to regulatory quality, it also would tend to encourage improved performance over time. A common and effective approach is to issue performance evaluations based on the quality of the RIA. For example, the Australian Office of Best Practice Regulation issues annual reports on RIA quality and compliance status.
- *Individual ministerial accountability.* Making ministers or high level civil servants personally accountable for the quality of RIA in their departments can make ministers more aware of RIA and the quality issues around RIA take a higher profile.
- *Expert scrutiny from peers.* The use of a transparent consultation process involving qualified and independent peer reviewers should improve the quality of and promote public confidence in the integrity of the government's analysis.
- *Building expertise amongst the regulation-makers.* The quality of RIA is dependent on the skills of the regulation-makers. Building the skills needed for good RIA takes time and investment in training, accessible written guidance material and technical support (that is through a helpdesk function).

APEC economies' experiences

70. The use of formal requirements for RIA and guidance on how to undertake RIA is widespread amongst APEC economies. Information on most economies' approach to RIA is identified in the Regulation/Deregulation of economies' respective Individual Action Plans.

Mexico

71. In Mexico, all regulatory proposals (including laws, major implementing regulations and decrees) that are likely to impose costs on individuals or businesses must be submitted to the Federal Commission of Regulatory Improvement (COFEMER) with a Regulatory Impact Analysis Statement (MIR). MIRs are reviewed by COFEMER with the assistance of the Regulatory Improvement Council, which comprises government and non-government representatives (including business, academic, labour and agricultural sectors).

Australia

72. In Australia, all regulations must be assessed by the department or agency proposing the regulation for significant impacts on compliance costs or other significant economic impacts (including impacts on competition) that are likely to be involved. The agency judges the threshold of what is 'significant,' however a record of the reasons for the judgement must be made and can be challenged by other agencies, including the Office of Best Practice Regulation (OBPR). A Regulation Impact Statement, which includes a cost-benefit analysis of the recommended option, compared to alternative options, must be completed by the responsible agency and approved by the OBPR.

New Zealand

73. New Zealand's RIA regime requires that policy proposals submitted to the Cabinet must be accompanied by a Regulation Impact Statement (RIS). Where policy proposals have compliance cost implications for business, the RIS must include a quantitative estimate of the compliance costs in a Business Compliance Cost Statement (BCCS). All RIS/BCCSs must be published on departmental websites. In addition, RIS/BCCSs must be assessed for their adequacy by the Regulatory Impact Analysis Unit (RIAU). The RIAU must insert a comment regarding the adequacy of the RIS/BCCS in the Cabinet paper to which it is attached.

References and further information

- OECD Methodological Guidance and Frameworks for RIA

Consultation mechanism

Introduction

74. Regulation has an impact on almost every aspect of our everyday lives. It sets the ground rules for the functioning of markets and of the society as a whole. Unfortunately, regulation is not always clear and it is sometimes overwhelming for individual citizens and businesses. Nevertheless, regulation remains one of the main ways to achieve economies' policy goals. For these reasons, it is important for economies to take the time to examine the quality of regulation and regulatory processes.

75. This Section deals with consultation as a tool to assure systematic quality in regulatory decision-making. It will provide APEC member economies with some insights to:

- encourage the use of consultation as a mechanism to enhance governments' accountability;
- rationalize their consultation procedures, and carry them out in a meaningful and systematic way;
- build a framework for consultation that is coherent and flexible enough to take account of the diversity of interests and strategies for each policy proposal; and
- promote mutual learning and the use of good practices.

The rationale for consultation

76. Broadly speaking, consultation has two high-level goals. On the one hand, it supports the so-called democratic values of transparency and accountability, on the other hand, it improves the overall effectiveness and efficiency of policy.

77. It is desirable that governments are open with their constituents regarding their actions, and accountable for the purposes and results of those actions. Regulatory uncertainty is reduced and effective compliance is promoted when information is provided about the regulatory actions and plans of regulators.

78. Likewise, regulatory proposals that are informed by public consultation are more likely to be efficient, effective and less prone to the risk of regulatory failure. Consultation may bring into the policy discussion the expertise, perspectives and ideas for alternative actions of those directly affected. It can also help regulators to balance opposing interests as well as identify unintended effects and practical problems. Transparency makes it easier to foresee the consequences of some planned policies, and therefore helps to identify the most productive and least costly ways to identify administrative burdens.

79. Furthermore, regulatory requirements are likely to be seen as more legitimate if affected parties have had the opportunity to play a role in their development, bringing the decision-making process closer to citizens, and consequently promoting easier implementation and better compliance with regulations.

80. In short, consultation can help policy officials to make better informed policy decisions because it:

- enables governments to obtain additional information from stakeholders and the public. This can provide extra context to a policy proposal along with the advantages of reviewing ex-ante the regulatory assumptions, bringing new ideas to face the problem, and providing a broader view than policy teams might otherwise be able to provide.
- encourages planning since there are early inputs from stakeholders as well as careful consideration of all policy options.
- highlights potential problems early on the process, so there is an opportunity to make any necessary adjustment.

81. Consultation is also effective in increasing trust and engagement with stakeholders since it:

- promotes transparency and accountability.
- improves awareness and understanding of the policy area.
- encourages public ownership of the policy, increasing public compliance with regulations.

Good practice guidance — principles and process

82. Although consultation practices vary from economy to economy, there are common principles that international literature recommends observing when conducting consultations.

- Participation
 - Ensure wide participation throughout the policy chain, consulting as widely as possible on major policy initiatives.
- Openness and accountability
 - Consultation processes must be transparent, both to those who are directly involved and to the general public. In particular, it must be clear what issues are being developed, which mechanisms are being used to consult, who is being consulted and the rationale for this, and which factors have influenced decisions in the policy formulation.
- Timeliness and continuity
 - Consultation should be a continuous process that starts as early as possible in the policy development process. Interested parties should be involved in the development of a policy at a stage where they can still have an impact on the formulation and design of the policy.
- Coherence and flexibility
 - There should be consistency and transparency in how government bodies and agencies operate their consultation processes. It is recommended that the effectiveness of departments' consultations be monitored, including through the use of a designated consultation coordinator wherever possible.

- Consistency should be balanced with the need for consultation to be designed to suit the circumstances of the particular proposal under consideration. Furthermore, public consultation for some proposals may be inappropriate, so governments should remain able to undertake other alternatives or initiatives that best deal with the purpose of the policy proposal.
- Content
 - All information and communications relating to consultation should be clear and concise, and should include all necessary information including information about the proposals, who may be affected, what questions are being asked and the deadline for responses.
- Targeting
 - Governments should ensure that all relevant parties have an opportunity to express their opinions. To ensure adequate coverage, it is recommended that consultation include: (i) those affected by the policy such as businesses, consumers, unions, environmental groups and other interested groups; (ii) those who will be involved in the implementation of the policy such as federal, state or municipal governments; and (iii) bodies that have a direct interest in the policy such as government departments, agencies, statutory authorities or boards.
- Accessibility
 - Governments should ensure that consultation documents are widely available and that their communication channels are adapted to meet the needs of all target audiences. It is widely recommended that the internet be used.
- Timeframe
 - There should be wide consultation undertaken throughout the process, allowing stakeholders sufficient time to provide a meaningful response.
- Acknowledgement and feedback
 - Contributions should be acknowledged and the outcome of the consultations should be made public, particularly indicating how the consultation process influenced the policy.
- Evaluation and review
 - Regulators should evaluate consultation processes and continue to examine ways of improving their effectiveness.

Public-Private Dialogue (PPD): A new trend in public consultation

83. In recent years there has been growing interest in the potential for dialogue between the public and the private sectors to promote the right conditions for private sector development and poverty reduction. In this context, public-private dialogue (PPD) has become an important part of the regulatory reform process.

84. PPD can come in several forms. It can be structured or ad hoc, formal or informal, wide-ranging or focused on specific issues. It can begin by being an initiative of the

government, companies or third parties. Different representatives may be involved, including public sector representatives, unions and civil society groups. It can be applied at the local, national or international level, and organized by an industry sector, or it can cover cross-cutting economic issues.

85. PPD can bring many benefits including the following:

- facilitating business climate reforms by supporting champions for reform, creating momentum, and accelerating the reform process;
- promoting studies of business climate problems and the design of policy reforms;
- making policy reforms easier to implement since the main affected groups can be able to understand the rationale behind the reform package;
- promoting transparency and good governance; and
- building an atmosphere of mutual trust and understanding between public and private sectors.

86. PPD can create risks if not implemented correctly including the following:

- it can reinforce vested interests and create opportunities for rent-seeking behavior if not sufficiently transparent and broad based;
- the PPD process may be captured by large firms or businesses if small and medium size enterprises and interested parties from states and municipalities are excluded;
- it can become a one-person show, collapsing if the key person loses interest or moves on;
- it can become merely a political exercise if not accompanied by sufficient efforts to build a broad base of support;
- efforts can be duplicated if they are not well coordinated with existing institutions or other dialogue mechanisms; and
- it can degenerate into a futile exercise if it is poorly planned and unfocused.

87. A study of the World Bank reveals there is no one-size-fits-all policy for PPD.¹ However, there is evidence that changes to economic regulation which have been carried out and supported by a public-private dialogue process have resulted in improved public policies. Additionally, changes coming from reforms with a common public-private understanding are more easily implemented, and the political costs of reforms are shared.

1 See Herzberg Benjamin & Wright Andrew, 'Competitiveness Partnerships Building and Maintaining Public-Private Dialogue to Improve the Investment Climate. A Resource Drawn from 40 Countries' Experience', at: <http://ideas.repec.org/p/wbk/wbrwps/3683.html> (December 2005).

Practical steps and tips to implement good practice

Consultation tools and forms

88. Dialogue between governments and interested parties can take many forms, and methods for consultation and dialogue are usually adapted for different policy fields. Generally, governments carry out consultation through online or written communications, advisory committees, expert groups, workshops and fora, ad hoc meetings and open hearings. However, consultation is frequently a combination of different tools and methods which are used depending on the phase of preparation of the policy proposal.

89. OECD has, nonetheless, identified five basic tools to perform public consultation.² The tools are used depending on the subjects being consulted, the degree of formality of the process, and the available means and technology to carry out the consultation.

90. **Informal consultation:** It can be carried out through telephone calls, informal meetings and can appear in any stage of the regulatory reform process. Its purpose is to collect information from the interested groups in an informal and fast way. Its acceptance is variable and participation depends on the interests at stake. One of the disadvantages of the informal consultation is that it can limit transparency.

91. **Distribution of regulatory proposals for public comment:** This form of public consultation is relatively inexpensive. It obtains views from the public and allows affected groups to provide wider information. It is flexible in terms of its depth and types of answers. This type of consultation occurs generally when the regulatory project is released. Answers are generally provided in written form, although in some cases oral answers or discussion sessions are used. This is by far the most used form of public consultation.

92. **Public notice and comment:** Public notice is more formal and structured, and provides stakeholders and the wider public with the opportunity to participate in the rule-making process within certain rules and timeframes.

93. **Public meetings:** Public meetings are organized in a way that interested groups are able to express their points of view face-to-face. Regulators may request that interested groups send the information in written form.

94. **Advisory bodies:** The use of this consultation tool has increased in the last years, especially in OECD economies. These bodies define positions and provide options of improvement to the regulatory proposals.

2 OECD, Background Document on Public Consultation (Paris: OECD, March, 2006).

APEC economies' experiences

Consultation in the Mexican Regulatory Impact Assessment (RIA) process

95. In Mexico, an RIA mechanism was introduced in 2000, as a result of the reforms to the Federal Law of Administrative Procedure. However, an RIA mechanism had been used for the Mexican Technical Standards since 1997.

96. Under the new legal framework, all federal governmental bodies are obliged in principle to submit their regulatory proposals and their corresponding RIA for consideration by COFEMER (the Federal Commission of Regulatory Improvement). No regulatory instrument can be published in the Official Gazette and therefore enter into force, without the opinion of COFEMER.

97. RIA assesses the impact in terms of costs, benefits and risks of any proposed regulation. In this context, public consultation has been introduced as a key element of the RIA process. In principle, all regulatory proposals and their corresponding RIA are made public. By law, all comments received by the stakeholders must be taken into account, thus enriching the discussion and analysis of the regulatory proposals.

Institutionalization of public-private dialogue in Mexico

98. Public-private dialogue (PPD) was institutionalized in Mexico through a reform carried out to the Internal Regulations of the Federal Council for Regulatory Improvement. The Federal Council is an advisory body of the Federal Commission on Regulatory Improvement (COFEMER). It was created in 2000 as a space for dialogue between the public, private and social sectors, and helps facilitate obtaining the views of such sectors regarding regulatory improvement and competitiveness.

99. An Executive Committee and Technical Working Groups were created in order to generate proposals and promote competition. This structure has helped promote discussions and specify how regulatory changes can be implemented in order to increase competition in the economy.

100. Prior to the institutionalization of the PPD, the Business Coordinating Council and COFEMER had worked jointly in the improvement of 63 areas identified as having a high impact on the competitiveness of specific sectors.

101. In 2005, a set of sectoral diagnostics was prepared in order to improve the competitiveness framework of businesses and reduce the costs for doing business in Mexico. All of the above were part of an integral and wide-ranging scheme called 'Systemic Vision'. As a result of Systemic Vision, 36 concrete actions concerning competition and regulatory improvement were established.

102. This has helped build an environment based on PPD in Mexico. However, there are still some aspects to improve and develop.

Utilizing PPD to create a Market for Reform: The case of Peru

103. Since 2004, actions have been implemented to improve the business climate in Peru. In order to complement these efforts, a public-private working group called Intermedia has been created to help ensure that there is broad-based support and an organized constituency to help plan and sustain reform initiatives.

104. The creation of Intermesa is the culmination of nine months of work by a partnership of the World Bank International Finance Corporation and *Ciudadanos al Dia* (CAD), a local NGO. In approaching this task the team consciously set out to create a market for reform, paying attention to both supply and demand of reform. This approach led to interesting variations on standard PPD approaches. For example, in addition to targeting business groups (demand), central government agencies (demand) and central and local political leaders (demand), the team also targeted technical level officials as both potential reform implementers (demand) and as potential consultants to other municipalities (supply). Intermesa also has a number of international cooperation groups in it, which helps to ensure that demand for reform is coordinated with support for supply of technical assistance.

105. Intermesa has played an integral role in spreading the reform process to new municipalities through its support for a national plan for municipal-level administrative reform in Peru (*TramiFacil*). It has grown to include more than 20 prominent public and private sector organizations, and has become deeply integrated in all aspects of the reform process.

References and further information

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 - Background document on public consultation (2006)
 - Policy Brief: measuring regulatory quality (2008)
- Website of the Public Private Dialogue <http://www.publicprivatedialogue.org/>
- Office of Best Practice Regulation (Australia)
 - Best Practice Consultation Requirements
- Cabinet Office: Better Regulation Executive (United Kingdom)
 - Code of Practice on Consultation
- Commission of the European Communities (Belgium)
 - Communication from the Commission: Towards a reinforced culture of consultation and dialogue — general principles and minimum standards for consultation of interested parties by the Commission (2002).

Enforcement and administration of regulation

Introduction

106. Regulatory frameworks define significant aspects of an economy's ability to protect its populace from harm and to engage in the global marketplace.

107. However, the case for regulation needs to be made carefully. Regulation needs to be designed and implemented in a way which achieves an economy's desired goals without imposing unfair or costly compliance on business or the wider community. In particular:

- regulation must be aimed at increasing the net benefit to society in circumstances in which this would not have been achieved without regulation; and
- economies increasingly need to understand that the way they regulate and the cumulative effect of different regulations can have significant, and unintended, impacts on business.

108. Levels of compliance will determine the ultimate effectiveness of any regulation. Compliance is facilitated in part by good regulatory design, and where this cannot produce optimal compliance in itself, by sound enforcement.

109. Effective regulatory design should result in regulation which achieves its intended aims at the least cost to businesses and citizens. The goal is to have well designed regulation which is administered well and which thus achieves its aims. The reality is that the resources available for the enforcement of legislation are often limited. Therefore it is important for regulators to develop strategies to ensure that two key criteria can be met.

109.1. Regulations are effectively administered to meet their aims, at least cost to business and citizens.

109.2. The regulator's limited resources are deployed in the most efficient way.

110. Poor enforcement strategies can bring the law into disrepute and can negatively impact on the willingness of individuals to comply voluntarily. Such strategies can also engender a sense of unfairness, which impacts on the way the law is viewed — the costs of the law can be seen as too high in comparison to the benefits.

111. The purpose of this chapter is to provide guidance on factors to take into account when developing enforcement strategies and implementing those strategies.

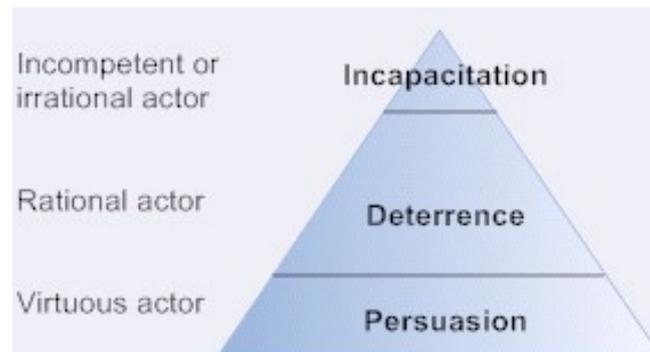
Good practice guidance — principles and practice

112. There is no set model of the administration and enforcement of regulation. Different economies have different outcomes sought by regulation, and different administrative and enforcement tools and differences in the way their citizens and businesses view compliance. There will also be issues around the capacity or even competence of a regulator to administer and enforce regulations in the manner desired.

113. Regulated sectors are not homogenous. Their participants have differing motivators and behaviours. Compliance strategies must be designed with this in mind and be flexible enough to cater for a range of behaviours and reactions to regulation.

114. It is now generally accepted international best practice that regulators should adopt enforcement strategies that enable them to take a different approach to those who are ill-informed and whose activities have low impact, as opposed to those who are ill-intentioned and whose activities have high impact or consequences.

115. This principle is illustrated by the *Braithwaite Pyramid*, a form of regulatory pyramid:



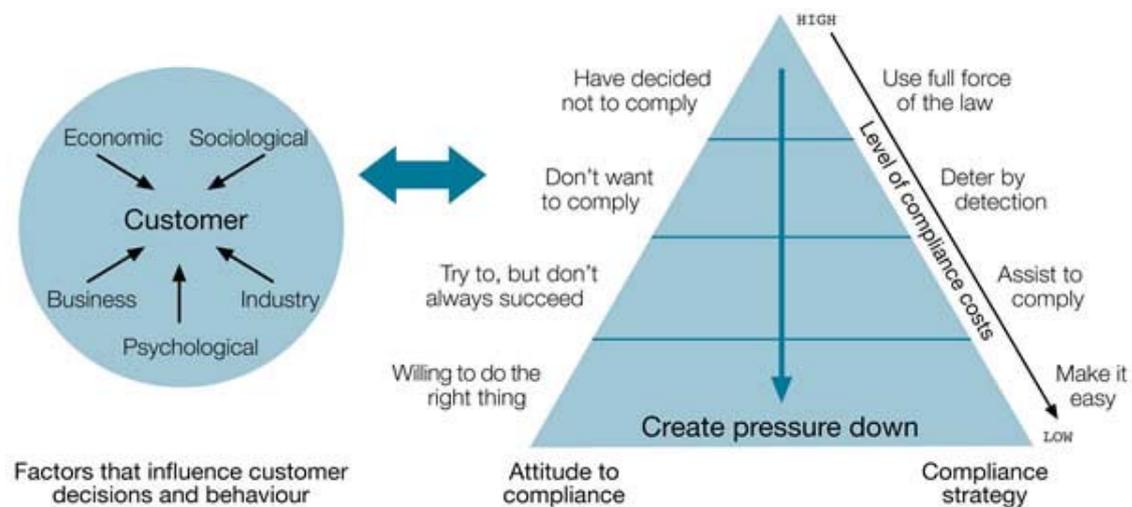
Source: Ayres, I and Braithwaite, J., *Responsive Regulation: transcending the deregulation debate* (1992), Oxford University Press, New York.

116. The *Braithwaite Pyramid* shows how an enforcement approach can be tailored to the factors motivating the actions of those who are regulated, with a hierarchy of graduated responses to non-compliance.

117. The pyramid has a number of layers, each of which represents a different enforcement activity a regulator could use. As you move up the pyramid the regulatory strategy changes from persuasion or education at the bottom through to the use of stronger tools such as sanctions or revocation of a licence, as each level/intervention fails. The objective is to stay low in the pyramid, although there is the flexibility to 'jump' to appropriate levels.

118. This principle can be supplemented by incentives by tailoring the level of enforcement or monitoring activity to the level of compliance. Such incentives can include the number of times a business is inspected. This means that those businesses that demonstrate high levels of compliance are visited less often than those who have lower levels of compliance.

119. As an example, New Zealand Inland Revenue developed a compliance model based on the following regulatory pyramid, which was influenced by the *Braithwaite Pyramid* and the experiences of the Australian Tax Office:



Source: New Zealand Inland Revenue, Annual Report 2007.

120. In many economies regulators are looking to vary and improve on the basic model.

121. In particular, the pyramid model can be used to reflect a punitive/enforcement approach based on tailoring sanctions to the behaviour of the regulated party (a *Regulatory Pyramid*), or a persuasion/education approach based on the good compliance practices of the regulated party (a *Strengths-Based Pyramid*). These pyramids can be used in conjunction to build on the strengths, and reduce the weaknesses of regulated parties to provide an integrated approach to encouraging compliance.

122. A critical issue to consider in seeking to achieve a high level of compliance with regulation is the early identification in the policy development process of the outcomes sought by regulation, and how the regulation will be administered, enforced and monitored.

Practical steps and tips to implement good practice

123. There are a number of steps that member economies may find useful in their consideration of enforcement strategies:

Step 1: Consider the strategic context of regulation

124. Develop a good understanding of:

- the reasons for regulation;
- the outcomes and objectives that regulation is expected to contribute to;
- the context in which regulatory decisions will be made and implemented; and

- any critical relationships or linkages to other areas of regulation.

125. This is necessary to help ensure that the approach proposed to achieving compliance is appropriate and sensitive to the broader context in which regulatory decisions will be made and implemented.

Step 2: Consider the operational context of regulation

126. Develop a good understanding of:

- the operational context including the characteristics of the sector or population being regulated;
- the extent to which the need for and outcomes of regulation are accepted;
- the likelihood of compliance or non-compliance;
- the capacity of a regulator to administer and enforce the regulations;
- the form of regulatory agency (Government Agency, Independent body, Industry Body); and
- how the regulatory agency is to be held accountable:
 - administrative procedure rules;
 - appeal system; and
 - performance assessment (purchase agreements with government).

127. Particular characteristics of the context will have material implications for the design of the compliance regime. For instance, a context in which the reasons and need for compliance are well understood, and the means of achieving compliance are within the capacity of those being regulated, would require less of an emphasis on initial communication of regulatory requirements than a regulation that is novel or new.

Step 3: Develop the compliance strategy

128. This strategy should build on the understanding of the strategic and specific regulatory contexts gained from steps 1 and 2.

129. The spectrum of options coincides with those in the *Braithwaite Pyramid*. At one level the strategy might be the communication of regulatory requirements to those being regulated. At another level it might be a letter of warning. At another level it might be punishment of those in breach of regulatory requirements.

130. One of the key questions to consider in developing the enforcement strategy is what an acceptable level of compliance is — is total compliance necessary, or will a lesser level do. This will be driven by how much compliance is needed for the regulation to meet its desired outcomes.

131. Other considerations of the strategy could include:

- the capacity of those being regulated to comply;

- how the regulatory requirements will be communicated;
- how non-compliance will be detected and by whom;
- how non-compliance will be deterred;
- whether enforcement is necessary in all cases of non-compliance;
- which sanctions are appropriate in first and repeat cases of non-compliance and who will apply those sanctions;
- whether it is clear that the strategy helps mitigate the problem being regulated and contributes to the purpose, outcomes and objectives of regulation;
- what are the expected costs of the proposed approach to achieving compliance to the regulator and those being regulated on a short-term and ongoing basis;
- whether the expected costs of achieving compliance (to both the regulator and those being regulated) are proportionate to the expected benefits of compliance; and
- whether the strategy has been documented.

Step 4: Implementation

132. Successful implementation of a compliance strategy is most likely when:

- roles and accountabilities for its implementation are clearly defined;
- necessary activities and tasks have been identified and planned for; and
- resource / funding implications have been identified and addressed.

133. There are a number of questions that could be considered:

- who is accountable for implementation;
- what are the specific functions associated with achieving compliance;
- whether those with compliance-related roles have the necessary technical knowledge and expertise;
- whether robust systems and processes are in place; and
- how the costs of compliance will be funded, and who will meet those costs.

Step 5: Monitor, evaluate and review

134. Monitoring and review of compliance is necessary to ensure that the approach taken is working as intended. Monitoring provides a basis for learning and making adjustments or changes to approaches as circumstances change, as the success of strategies is known, and as the regulated sector evolves over time.

135. For an enforcement agency it is important to be clear about what is being measured and how frequently, and determine what is meant by success. It is also important to retain a degree of flexibility to consider how information on compliance can be used to modify or adjust implementation of the compliance strategy. The regulator will also need to consider the scale of any review of regulatory compliance and how the results of any such review or evaluation are used.

136. A more detailed outline of these steps is available at <http://www.med.govt.nz/regulation>.

APEC economies' experiences

The New Zealand Commerce Commission

137. The New Zealand Commerce Commission enforces legislation that promotes competition in New Zealand markets and prohibits misleading and deceptive conduct by traders. The Commission also enforces a number of pieces of legislation specific to the telecommunications, dairy and electricity industries.

138. The Commission vets cases and decides upon the level of enforcement action based on three main criteria:

- the nature and extent of the detriment;
- the conduct of the particular business; and
- the level of public interest.

139. From this vetting process decisions are made regarding which enforcement response to adopt.

140. Historically, the Commission has used a range of interventions.

141. However, the Commission's experience showed that for these enforcement interventions to be effective, the interventions at the 'top' of the pyramid needed to present a real threat, as this leads to the most sustained behaviour change.

142. The behaviour of certain businesses did not change until they realised that they would face substantial consequences as a result of breaches of the law. This, in turn, gave sanctions genuine 'teeth' and impact. To emphasise this, the Commission targeted cases with a high detriment to consumers and competition and sought, and obtained, not only significant penalties through the judicial system, but also significant compensation awards.

143. This has resulted in increased cooperation with the Commission, an increase in guilty pleas, and, in some cases, industry-wide changes in behaviour.

144. Having achieved initial success, the Commission will both widen the range of interventions taken (for example, increased use of settlements, publishing guidelines for business, education) while also continuing to prosecute the most serious breaches of the laws it enforces.

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- Australian Productivity Commission: <http://www.pc.gov.au/>
- Australian Tax Office compliance strategy:
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Alternatives to Regulation

Introduction

145. The foundation of modern nations' governance structures on the rule of law as the main governing instrument creates a strong bias for the use of law to carry out policy. Direct legal regulation (often referred to as black-letter, prescriptive or command-and-control regulation) can be a powerful tool, although in many circumstances alternatives to prescriptive regulation may achieve an economic, social or environmental objective more effectively and at a lower cost. The consideration of regulatory alternatives therefore is an important issue.

146. Traditionally, regulation has been limited to legally enforceable 'rulings' by parliaments, governments and regulators. It is characterised by: attempts to change the behaviour of groups or individuals by detailing how regulated entities should act; a general reliance on government inspectors and/or monitoring to detect non-compliance; and the imposition of punitive sanctions, such as fines or imprisonment.

147. Prescriptive regulation often is preferred by regulators, particularly in dealing with high-impact, high-risk public issues where there is an imperative to provide certainty about desired behaviours and, in theory at least, non-compliance is easier to detect, compared with alternatives to regulation. However, prescriptive regulation may not be suitable for achieving all objectives. In particular, prescriptive regulation has the following costs, which may be more or less relevant to particular policy situations.

- It may be standardised and inflexible. This means that it may not adequately deal with diverse conditions or with changes over time. This can result in the regulation becoming outdated and even counter-productive. It may also impede technological progress and innovation.
- It may, over time, generate more regulation. For instance, new regulation is created to adapt the original regulation to a new situation or to close the gaps where compliance is not being achieved. In this way regulators are constantly reacting, after instances of non-compliance, to improve the regulation.
- In economies with a parliamentary style government, there are potentially significant time lags inherent in making and amending law.
- Law may not be well suited for influencing complex situations (for example, situations where desired market outcomes are identified but the behaviours required to achieve them are not well understood by regulators).
- Government budgetary costs are often higher with prescriptive law and there may be less accountability for administrative costs, compared with other regulatory forms that utilise the resources of regulated entities.

Good practice guidance — principles and processes

148. The *APEC-OECD Integrated Checklist on Regulatory Reform* emphasises the importance of considering alternatives to regulation at an early stage of the policy development process. It is noted also in the Checklist that the range of policy tools and

their uses is expanding as experimentation occurs, learning is shared and understanding of the potential role of markets increases.

149. The development of alternatives to regulation is a relatively new discipline for policy makers and regulators. From the regulator's viewpoint, adopting a non-regulatory approach, where command and control regulation is the tool traditionally used, necessarily involves a risk linked to the use of untried approaches and thus to a real or perceived failure to develop adequate responses. A clear leading role — supportive of innovation and policy learning — must be taken by reform authorities if alternatives to traditional regulation are to make serious headway into the policy system.

150. The OECD's *Reference Checklist for Regulatory Decision-Making* (1995) also has emphasised the importance of a range of options when considering how to deal with a policy issue. It is noted in the checklist that 'regulators should carry out, early in the regulatory process, an informed comparison of a variety of regulatory and non-regulatory policy instruments, considering relevant issues such as costs, benefits, distributional effects and administrative requirements'.

151. Irrespective of whether a prescriptive regulatory approach or an alternative to regulation is adopted, the methods adopted to deal with a perceived problem should ideally have the following characteristics.

- Administrative simplicity. The objectives of the regulation should be clear to the regulator and regulated entities.
- Flexibility: The regulatory system must be able to adapt to changes in the environment in which regulated entities operate.
- Efficiency: The chosen method of regulation should achieve its objectives at least cost to government and the community.
- Equity: The regulation should not confer an advantage on some regulated entities over others (other than that explicitly intended by the policy-maker).

Types of regulatory alternatives

152. Broadly, there are three categories of alternatives to regulation.

152.1. **Co-regulation.** Co-regulation is characterised by Government providing legislative support for industry initiatives but delegating authority for management of the initiative (including detailed rule-making) to industry.

152.2. **Quasi-regulation.** Quasi-regulation is characterised by the government taking action which is not legally binding, but which adds to regulatory rules and there are sanctions for non-compliance. Some examples of quasi-regulation include government endorsed industry codes of practice or standards, government issued guidance notes, industry-government agreements and accreditation schemes.

152.3. **Self-regulation.** Self-regulation generally is characterised by industry formulating rules, standards and codes of conduct, with industry solely responsible for enforcement. Government may act in an advisory capacity.

153. Within each of these approaches, alternative regulatory tools can be employed to achieve a desired regulatory objective. The suitability of each approach will vary depending on the objectives of the regulation-maker and the social or business environment in which the regulation will be applied. Use of more than one regulatory tool may be appropriate to address a single regulatory issue.

153.1. **Performance (outcome) based regulations.** Performance-based regulation specifies required outcomes or objectives, rather than the means by which they must be achieved. Firms and individuals are able to choose the process by which they will comply with the law. This allows them to identify processes that are more efficient and lower cost in relation to their circumstances, and also promotes innovation and the adoption of new technology on a broader scale.

153.2. **Process (behaviour) based regulations.** Process-based regulation requires businesses to develop processes that ensure a systematic approach to controlling and minimising risks. Process regulations are based on the idea that, given the right incentives, producers are likely to prove more effective in identifying hazards and developing lowest-cost solutions than is a central regulatory authority. They are particularly useful where there are multiple and complex sources of risk, and ex-post testing of the outcome is either relatively ineffective or prohibitively expensive.

153.3. **Economic instruments.** Economic instruments operate directly through the market and include taxes, subsidies, tradeable permits and vouchers. These instruments can be more efficient than prescriptive regulation because they allow individuals to make their own cost-benefit trade-offs in pursuing certain behaviour. Consequently, they may achieve desired regulatory outcomes more efficiently. However, the outcomes associated with these approaches may be less certain than those associated with prescriptive regulation.

153.4. **Provision of information and education.** These strategies seek to alleviate the problem by changing the quality of the information available, or its distribution. Government may collect and distribute information centrally, or may require regulated entities to make certain information public. These measures are intended to improve market functioning by allowing people to make better informed decisions. The main advantage of these strategies compared to some other approaches is that they allow individuals to choose what is best for them given the information available, rather than imposing one solution on all.

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

Practical steps and tips to implement good practice

154. The form of regulatory intervention, if any, that will be appropriate for a given situation will vary, depending on the social, economic and political circumstances. Consideration should be given to alternatives to regulation as early as possible in the policy development process to allow sufficient time to test the impacts of each alternative option.

155. There can be a number of potential advantages associated with self-regulation, quasi-regulation and co-regulation compared with prescriptive regulation. These include the following:

- lower government administration costs and lower compliance costs on regulated entities;
- innovative inducements for compliance and sanctions for non-compliance, which may lead to high rates of compliance;
- rules that are better targeted to specific needs;
- improved credibility because rules can be developed by regulated entities, not imposed by governments; and
- enhanced flexibility, responsiveness and speed of implementation and modification.

156. Self-regulation, quasi-regulation and co-regulation can include the following potential disadvantages.

- Creation of restrictions on competition (for example, barriers to entry, restrictions on advertising, prescribed prices).
- Reductions in consumer choice, by creating minimum standards that do not allow consumers to choose lower-cost/quality products or services.
- Creation of expectations of compliance by governments and consumers, which are not met when some businesses do not comply.
- Ineffective sanctions for non-compliance.
- Creation of confusion about regulatory requirements.
- Costs to businesses to develop or administer quasi-regulatory schemes.

157. The nature of these advantages and disadvantages lead to the following indicators where self-regulation, quasi-regulation and co-regulation approaches are likely to be more effective.

158. Indications that self-regulation should be considered as a viable option include the following:

- there is no strong public interest concern, in particular, no major public health and safety concern;
- the problem is a low-risk event, of low impact or significance;

- the problem can be fixed by the market itself. For example, there may be an incentive for individuals and groups to develop and comply with self-regulatory arrangements (industry survival, market advantage);
- there is a cohesive industry with like-minded or motivated participants committed to achieving the goals and there exists or it is possible to establish a viable industry association with adequate coverage of the industry concerned;
- evidence that voluntary participation can work — effective sanctions and incentives can be applied, with low scope for the benefits being shared by non-participants; and
- there is evidence of a cost advantage from tailor-made solutions and less formal mechanisms, such as access to quick complaints-handling and redress mechanisms.

159. Indicators that quasi-regulation should be considered include the following:

- there is a public interest in some government involvement in regulatory arrangements and the issue is unlikely to be addressed by self-regulation;
- there is a need for an urgent, interim response to a problem in the short term while a long-term regulatory solution is being developed;
- government is not convinced of the need to develop or mandate a code for the whole industry;
- there are cost advantages from flexible, tailor-made solutions and less formal mechanisms, such as access to speedy, low-cost complaints handling and redress mechanisms; and
- there are advantages in the government engaging in a collaborative approach with industry, with industry having substantial ownership of the scheme. For this to be successful, there needs to be:
 - a specific industry solution rather than regulation of general application;
 - a cohesive industry with like-minded participants, motivated to achieve the goals;
 - a viable industry association with the resources necessary to develop and/or enforce the scheme;
 - effective sanctions or incentives to achieve the required level of compliance, with low scope for benefits being shared by non-participants; and
 - effective external pressure from industry itself (survival factors), or threat of consumer or government action.

160. Indicators that co-regulation should be considered include:

- Where there is a willingness on the part of a majority of regulated entities to develop industry-codes or standards, but there is no viable incentive structure (other than legal compulsion) to prevent a significant portion of the industry from not participating.

161. Care must be taken to ensure any proposed self-regulatory, quasi-regulatory or co-regulatory approaches are not anti-competitive. For example that they do not restrict the entry of new market participants or favour a particular cohort of regulated entities.

APEC economies' experiences

162. The explicit consideration of alternatives to prescriptive regulation is a relatively new concept. However, it is spreading rapidly. OECD data from 2006 indicates that explicit assessment of regulatory alternatives exists either economy-wide or for specific sectors in most OECD economies.

163. In addition, anecdotal evidence drawn from self-assessments against the *APEC-OECD Integrated Checklist on Regulatory Reform* indicates that consideration of alternatives to regulation is part of the regulatory impact analysis requirements of APEC economies.

Australia

164. In Australia, the Best Practice Regulation Handbook, issued by the Office of Best Practice Regulation encourages policy officers to consider non-regulatory solutions as early as possible in the policy development process and for regulations that have a significant impact, to discuss viable non-regulatory options as part of the Regulation Impact Statement. Guidance is provided on the matters to consider in developing proposals for alternatives to regulation.

Hong Kong, China

165. In Hong Kong, China, Regulatory Impact Assessment (RIA) is not compulsory for new regulatory proposals. However, it is often done for major policy proposals with a significant regulatory impact. Where RIA is undertaken, it must include an assessment of the merits of viable regulatory and non-regulatory options.

Korea

166. In Korea, the Manual for Developing Regulatory Alternatives, published by the Regulatory Reform Committee and distributed to all ministries in 2005, encourages ministries to consider alternatives to regulation, as well as overlaps with similar existing regulations.

References and further information

- APEC-OECD Integrated Checklist on Regulatory Reform
- OECD Indicators of Regulatory Management Systems Quality