



Guide to Better Regulation



Better
Regulation
Office

November 2009

November 2009
www.betterregulation.nsw.gov.au

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Better Regulation Office
NSW Department of Premier and Cabinet

ISBN: 978-0-7313-5408-5

First published by the Better Regulation Office,
NSW Department of Premier and Cabinet in April 2008.
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The Guide to Better Regulation applies to all new and amending regulatory proposals.

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Introduction

The Guide

The Guide to Better Regulation assists agencies develop regulation which is required, reasonable and responsive. The Guide provides details on how to apply the seven better regulation principles to meet the Government's commitment to cut red tape.

- **The Better Regulation Requirements**

This section outlines the better regulation principles, explains how to determine if a regulatory proposal is significant and details how to apply the better regulation principles.

- **Preparing a Better Regulation Statement**

This section provides guidance on preparing and submitting Better Regulation Statements.

- **Appendices**

The appendices provide more detailed information to supplement the Guide. Appendix A describes types of market failure. Appendix B provides details on non-regulatory and regulatory approaches, together with case studies. Appendix C provides information on assessing the costs and benefits of various options.

It is important to note that many aspects of the Guide are consistent with regulatory development approaches that are currently practised in NSW Government agencies. The Guide clarifies what is expected in terms of good regulatory practice, and introduces some new concepts and processes to ensure consistency.

The Guide implements the requirements set out in Premier's Memorandum 2009-20. It supports achievement of the Government's renewed commitment to develop and enhance existing processes for regulation making and review under the Council of Australian Governments (COAG) Seamless National Economy National Partnership Agreement.

The Better Regulation Office is available to provide agencies with assistance and advice at any time. Agencies working on significant regulatory proposals should consider approaching the Better Regulation Office early in the development process.

Minister for Regulatory Reform

The Minister for Regulatory Reform is the champion for better regulation making in the Cabinet, working right at the heart of government decision making. The Minister, who is responsible for implementing the Government's commitment to cut red tape:

- provides strategic policy advice on whether regulatory proposals submitted to Cabinet or the Executive Council demonstrate compliance with the better regulation principles
- reviews and approves Better Regulation Statements submitted with all significant regulatory proposals, and
- brings the assessment underlying that approval to the attention of Cabinet or, in the case of Executive Council proposals, the Premier.

Better Regulation Office

The Better Regulation Office is situated within the Department of Premier and Cabinet and supports the Minister for Regulatory Reform.

The Office drives regulatory reform and is an advocate for better practice regulation making across government. The Office:

- acts as a gatekeeper, reviewing and advising the Minister on compliance with the better regulation requirements. This role includes providing advice on Cabinet proposals and on Regulations and other Statutory Instruments going before the Executive Council, as well as providing advice on whether Better Regulation Statements are adequate and should be approved
- conducts targeted reviews, as directed by the Minister, into specific regulatory areas or industries where reducing red tape will benefit the State's economy including small business
- monitors and reports on compliance with the better regulation requirements and reform outcomes including through the release of an Annual Update and reporting on progress towards the Government's \$500 million red tape reduction target, and
- provides ongoing advice and practical tools to assist agencies meet the better regulation requirements.

What is expected?

The better regulation requirements have been in place since 1 June 2008. As part of meeting these requirements:

- New and amending regulatory proposals must demonstrate compliance with the better regulation principles.
- A Better Regulation Statement is required for significant new and amending regulatory proposals and must be approved by the Minister for Regulatory Reform.
- The impacts of the proposed regulation must be identified and justified through quantitative and qualitative analysis. The level of analysis should be proportionate to the level of significance of the proposal.
- Opportunities to simplify, repeal, reform or consolidate existing regulation should be considered.
- Planning for implementation, compliance, enforcement and monitoring must be undertaken as part of regulatory development to improve regulatory design and avoid unnecessary compliance costs.
- Effective consultation with stakeholders is required to inform the development of regulatory proposals and to assist the Government to thoroughly understand the impacts.
- Regular review is required so regulation remains relevant, continues to meet its policy objectives and does not impose unnecessary regulatory burdens as circumstances change.

Definitions

The term **regulatory proposal** is used in this Guide in the broadest possible sense to cover any scheme or requirement imposed by Acts of Parliament, regulations made under those Acts, or by Statutory Instruments.

Regulatory burdens are costs imposed by regulatory requirements, including unnecessary regulation (or 'red tape'). Costs may be borne by businesses, government, and the community and include:

- *administrative compliance costs* associated with demonstrating compliance with a regulation (such as paperwork and record-keeping costs)
- *substantive compliance costs* related to required capital and production expenditure (such as equipment and training expenses)
- *financial costs* which are payments made directly to the Government (such as fees, levies and fines), and
- *indirect costs* relating to the impact that regulation has on market structures and consumption patterns (such as restrictions on innovation and barriers to entry through licensing) and the cost of delays.



The better regulation requirements

Regulation

Regulation is an important tool available to government. Well designed and properly targeted regulation helps deliver the community's economic, social and environmental goals. However, regulation can also impose administrative and compliance burdens on business, consumers, government and the wider community. These burdens must be weighed against the benefits that the regulation generates.

An effective and efficient regulatory environment creates the climate for a competitive and productive economy. Effective and light handed regulation minimises the time businesses spend complying with regulatory requirements, increasing their ability to innovate, be entrepreneurial and respond creatively and quickly to market opportunities or threats.

The NSW Government is committed to cutting red tape as a key part of its economic policy. Under the State Plan, the Government has committed to cut red tape by \$500 million by June 2011. The Government's emphasis on good regulation will help NSW remain an attractive place for Australian and international business investment with an economy that continues to generate jobs and growth. **Figure 1** (page 8) outlines the NSW Government's framework for cutting red tape.

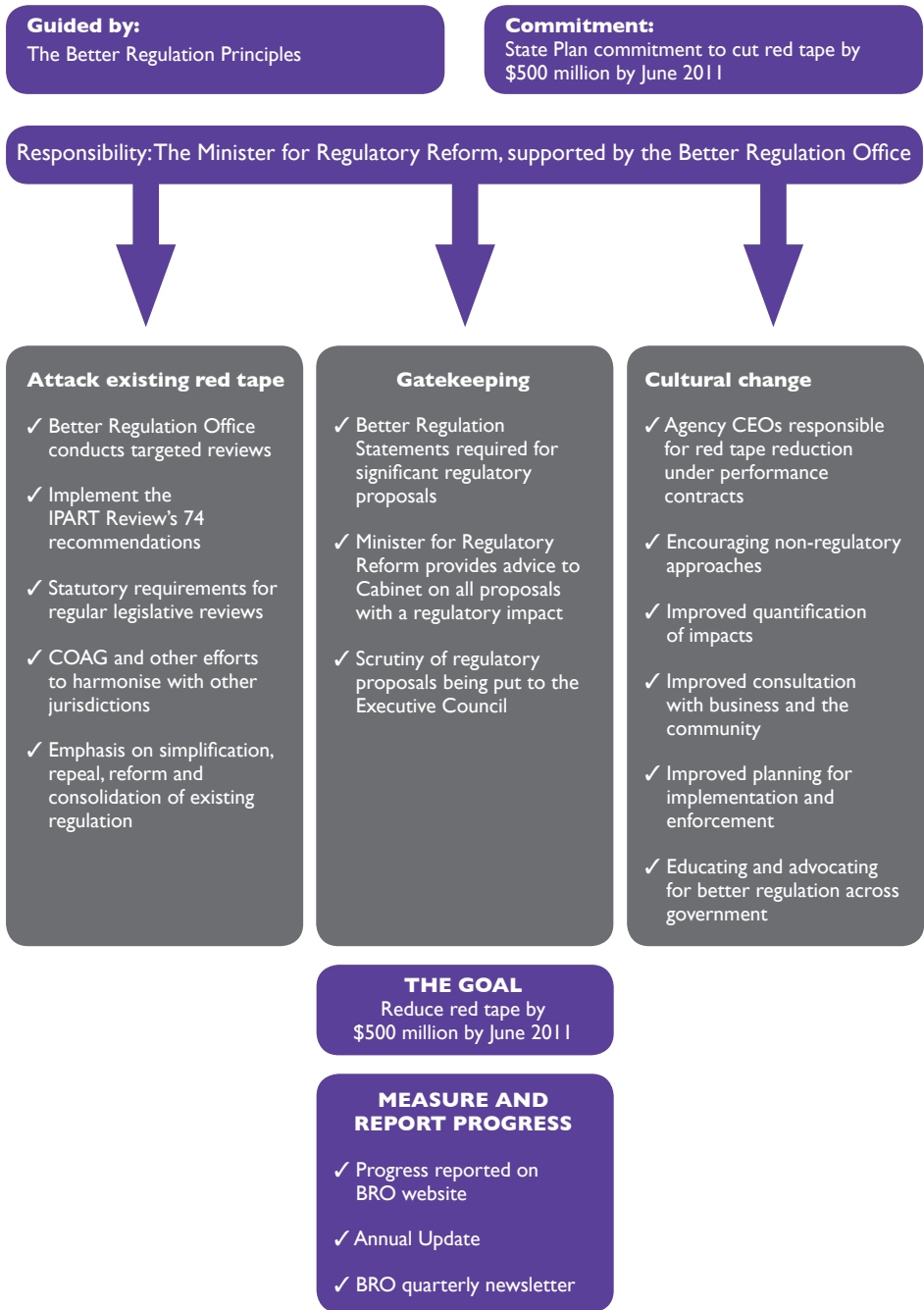
Better regulation principles

The NSW Government has articulated what characterises good regulation and the minimisation of red tape through seven better regulation principles. Better regulation is the result of sound policy development and regulatory design processes. The principles are the cornerstone of the Government's commitment to good regulation and must be followed in the development of every regulatory proposal. In doing so, it is demonstrated that the proposal is required, reasonable and responsive.

THE BETTER REGULATION PRINCIPLES

- Principle 1: The need for government action should be established
- Principle 2: The objective of government action should be clear
- Principle 3: The impact of government action should be properly understood by considering the costs and benefits of a range of options, including non-regulatory options
- Principle 4: Government action should be effective and proportional
- Principle 5: Consultation with business and the community should inform regulatory development
- Principle 6: The simplification, repeal, reform or consolidation of existing regulation should be considered
- Principle 7: Regulation should be periodically reviewed, and if necessary reformed to ensure its continued efficiency and effectiveness

Figure 1: NSW Government framework for cutting red tape



Requirements

All new and amending regulatory proposals submitted for the approval of **Cabinet** or the **Executive Council** must demonstrate that the better regulation principles have been applied¹. For significant proposals a Better Regulation Statement is required.

The Minister for Regulatory Reform provides advice to the Premier on whether the principles have been applied and whether the regulatory burden being proposed is justified. If the Minister for Regulatory Reform has concerns about a regulatory proposal, the Minister may ask the Premier to defer consideration of the proposal until the concern is resolved.

Significant regulatory proposals

All significant new and amending regulatory proposals are required to demonstrate that the better regulation principles have been met through a Better Regulation Statement. The Statement must be submitted with the Cabinet Minute or Executive Council Minute and be approved by the Minister for Regulatory Reform.

Portfolio Ministers are responsible for determining whether a regulatory proposal is significant. This will need to be determined on a case by case basis, but in general, a regulatory proposal is considered significant if it would:

- introduce a major new regulatory initiative
- have a significant impact on individuals, the community, or a sector of the community
- have a significant impact on business, including by imposing significant compliance costs
- impose a material restriction on competition, or
- impose a significant administrative cost to government.

The decision of the portfolio Minister is subject to the views of the Premier and Cabinet, informed by the Minister for Regulatory Reform.

The next section of the Guide provides guidance on how to prepare a Better Regulation Statement. Agencies can also contact the Better Regulation Office for advice and guidance on preparing a Better Regulation Statement.

Non-significant regulatory proposals

For non-significant proposals, portfolio Ministers must demonstrate that the better regulation principles have been applied through the following processes:

- Where a regulatory proposal is being submitted to **Cabinet** for approval, evidence of the application of the better regulation principles must be provided in the Cabinet Minute. Clearly addressing the principles in the Minute will minimise delays in the approval process.
- Where a regulation or other Statutory Instrument is being submitted to the **Executive Council** for approval, documentation must be submitted with the Executive Council Minute which demonstrates that the better regulation principles have been applied. This may be in the form of a letter to the Minister for Regulatory Reform, analysis prepared in accordance with Schedule 1 of the *Subordinate Legislation Act 1989*, relevant information from a Regulatory Impact Statement, Cabinet Minute or Ministerial briefing note or any other document which justifies a regulatory proposal.

¹Regulation which is amended in Parliament is not captured by the better regulation requirements.

Exempt regulatory proposals

Certain regulatory proposals are exempt from the better regulation requirements. If a proposal is exempt, then articulating how the proposal meets the better regulation principles is not required. The following are exempt:

- Regulatory proposals which are related to police powers and general criminal laws or the administration of justice, such as rules of court and sentencing legislation.
- Regulatory proposals which are related to electoral rules.
- Regulatory proposals which are related to the management of the public sector.
- Regulatory proposals which correct drafting errors, make consequential amendments or are of a machinery nature.
- Excluded instruments under Schedule 4 of the *Subordinate Legislation Act 1989*.
- Regulatory proposals which propose standard fee increases, specifically, changes in line with or below increases in the Consumer Price Index.
- Regulatory proposals which have already been subject to a detailed assessment against the better regulation principles as part of an earlier Cabinet Minute or Executive Council Minute. In such cases, this should be identified and no further demonstration of meeting the principles is required. This exemption is contingent on adequate and prior assessment of the specific regulatory proposal.
- Regulatory proposals developed and assessed through external processes. This may include Ministerial Council and COAG processes or other processes undertaken on behalf of government by independent bodies such as the Independent Pricing and Regulatory Tribunal (IPART) or the Productivity Commission. Where these processes demonstrate the elements of good quality regulatory development, which at a minimum includes detailed regulatory impact assessment and public consultation, it is not necessary to duplicate this work when seeking approval at a NSW level. However, a short description of the process undertaken and a web link to relevant supporting information should be provided.

Agencies can obtain further clarification of exempt proposals by contacting the Better Regulation Office.

Subordinate Legislation Act 1989 requirements

The requirements of the *Subordinate Legislation Act* (the Act) continue to apply to statutory rules in NSW. Under the Act:

- statutory rules (that is, regulations, By-laws, Rules or Ordinances) must be reviewed every five years
- a Regulatory Impact Statement must be prepared for all new statutory rules in accordance with Schedule 2 of the Act. Requirements for consulting on Regulatory Impact Statements and providing advice to the Legislation Review Committee also apply, and
- analysis must be prepared for all amending statutory rules in accordance with Schedule 1 of the Act.

Where a new regulation is significant², the Regulatory Impact Statement can be submitted with a Cabinet Minute or an Executive Council Minute in the place of a Better Regulation Statement. To meet the better regulation requirements, however, the outcomes of consultation and justification for the final regulatory

²As significance depends on the nature of the proposal and impacts rather than the type of regulatory instrument, a new statutory rule is not necessarily significant. As such, the requirement to submit a Better Regulation Statement or a revised Regulatory Impact Statement will not apply for all new statutory rules.

proposal must also be presented. This can be done through revising the Regulatory Impact Statement or providing this information in the Cabinet Minute itself or a separate document.

The Act is available on the NSW Government legislation website at www.legislation.nsw.gov.au.

Applying the better regulation principles

The basic process for demonstrating compliance with the better regulation principles is illustrated in **Figure 2** (page 12). Guidance on how to apply the better regulation principles follows, including questions to consider when developing a regulatory proposal.

Principle 1: The need for government action should be established

It is important to establish that a problem exists before determining whether government action is necessary.

The source, nature and scale of the problem, and its impacts, should be clearly identified. A problem should be demonstrated with evidence, using data if possible. Understanding the problem may require some research to ensure the 'root cause' of the problem is identified rather than the symptoms. Consultation with key stakeholders may also help accurately identify a problem.

Government action is commonly justified on the basis of responding to market failures or imbalances. It is important to determine whether there is a need for government to be involved, or whether the problem will be solved through market forces or by existing regulations at the State or Commonwealth level.

Appendix A provides information on the types of market failure.

Government intervention may be justified in order to achieve social or environmental objectives that would not be achieved by the market. These may include:

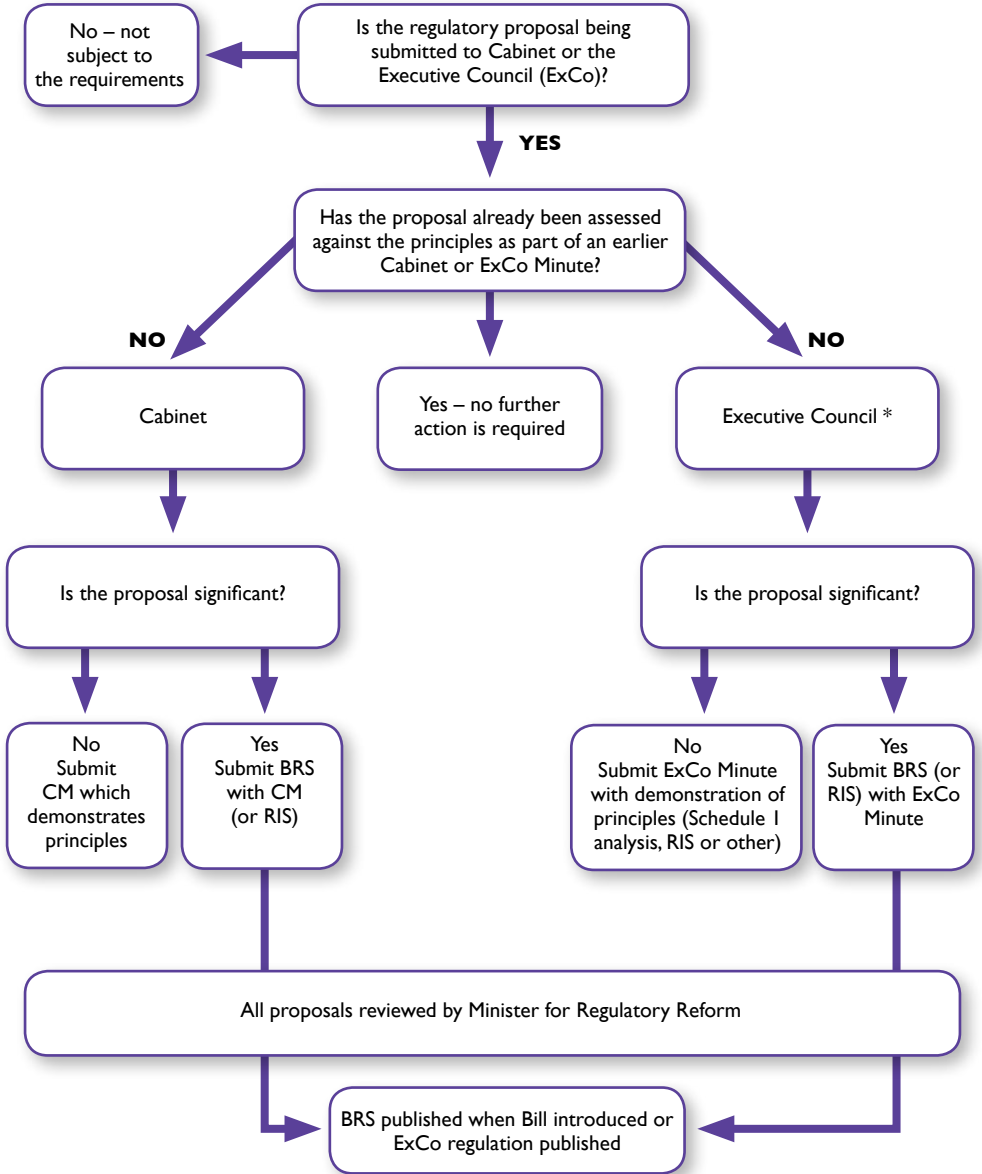
- promoting equitable outcomes or a minimum standard of living across the community. Examples include social security systems and public health
- providing 'merit' goods and services that society as a whole values, even if the individuals that make up that society do not always demand them. Examples include 'high art' forms such as opera and ballet as well as 'demerit' goods like problem gambling, and
- ensuring the safety of society by protecting people from crime or abusive behaviour.

Agencies need to consider taking no action. A balance between the level of risk associated with a problem and the impact of government action needs to be achieved. Government action should only occur where it is in the public interest, that is, where the benefits outweigh the costs.

Quick reference guide – NEED FOR ACTION

- What is the problem to be solved?
- How big is the problem and how severe are its consequences?
- What are the broad impacts of the problem and who is affected?
- Have affected parties been consulted on the nature and impact of the problem?
- What will happen if no action is taken?

Figure 2: Demonstrating compliance with the better regulation principles



** Subordinate Legislation Act 1989 requirements apply to all statutory rules (see page 10)*

Principle 2: The objective of government action should be clear

The objectives of a regulatory proposal should:

- be clear, concise and specific
- directly target the root cause of the problem
- where possible, be measurable (eg by specifying an outcome and a time period over which the objective is to be achieved), and
- be consistent with existing government objectives or policies.

Objectives should be expressed in terms of the ends to be achieved, rather than the means of achieving them. For example, the objective of a regulatory proposal might be 'to reduce road injuries and fatalities' rather than 'to ensure that all car users wear a seatbelt' (the means to achieve the objective).

Any constraints on the objectives should be identified. For example, if an objective must be defined within a certain budget it will not be possible to consider options which are more costly.

Clear objectives are also valuable when conducting reviews later in the regulatory development process. They help to evaluate the success of a regulatory solution by determining how it is achieving its stated objectives.

Quick reference guide – OBJECTIVES

- What is the outcome to be achieved?
- Are objectives specified clearly?
- Do objectives relate to the problem which has been identified?
- Are objectives consistent with existing government objectives and policies?

Principle 3: The impact of government action should be properly understood by considering the costs and benefits of a range of options, including non-regulatory options

The key components of determining the impact of government action include: developing viable options; assessing the impact of options; developing a plan for implementation and compliance; and considering how performance will be monitored and reported.

Develop Viable Options

A range of options should be considered, starting with the least interventionist. You must consider the option of taking no action or maintaining the status quo. Other options that may be considered include:

- non-regulatory approaches like provision of information, self-regulation, quasi-regulation or co-regulation
- creating markets or developing market based instruments such as through imposing government charges or creating financial liability for the detrimental effects of an activity, and
- performance based versus prescriptive regulatory approaches.

These options are discussed in more detail in **Appendix B**.

Consultation with relevant stakeholders can help identify options and provide information on their feasibility and expense. For example, consultation with stakeholders can help determine the kinds of information and/or penalties that they will respond to.

National or cross border harmonisation of regulation should be considered as an option where possible, recognising that businesses that operate in several jurisdictions can face significant costs when forced to

comply with different regulatory regimes. Harmonisation can minimise duplication of effort, save money and enhance consistency for business. Of course, a decision on the preferred option should be based on an assessment of the costs and benefits. Harmonisation should not be a goal in itself – NSW policy objectives and the impacts of regulation on NSW businesses and community should be the key consideration.

Design options to promote innovation

Well designed options can encourage innovation. 'Innovation' is generally defined as the development of improved products, services and processes, the creation of new markets, and the use of new products.

Where appropriate, regulation should adopt an outcome focused approach rather than being prescriptive. Efficient firms will respond by developing more innovative ways to operate and comply. Leaving the path open for firms to choose how they achieve a certain outcome can also reduce the real cost of regulation to a level lower than the cost originally predicted by government.

Setting minimum performance levels to ensure certain standards can have some negative effects on innovation. Mandated minimum standards do little to encourage good performers to do better and can actually impede the best performers by creating unnecessary burden – or red tape. An alternative option is to consider incentives for better than average performance.

Quick reference guide – OPTIONS

- Have a number of options been considered, including non-regulatory alternatives?
- Has the status quo been considered as an option?
- Do the options reflect the significance of the problem to be addressed and the availability of resources?
- Can existing regulation be amended to achieve the objectives?
- Have options used to address similar policy problems in other jurisdictions been considered?
- Can national or cross border harmonisation be pursued?
- Is there a less interventionist form of regulation available that will achieve stated objectives?
- Have the interaction with existing regulatory schemes, the type and structure of the industry involved (including existing institutional structures), the need for flexibility or certainty in the regulatory approach and the potential burdens associated with implementation and compliance been considered?
- Have stakeholders been consulted to assist with options development?

Assess the impact of options

The elements of good impact assessment processes are discussed below.

Identify those affected

The assessment of costs and benefits should examine the impacts of options on particular groups as well as the community as a whole. Particular attention should be paid to the impacts of proposed options on small businesses, which constitute approximately 95 percent of all enterprises in NSW³. The burden of regulation can impact disproportionately on small business as they have less ability to absorb compliance costs. They also have limited resources to interpret and implement compliance requirements, and to keep pace with the cumulative burden of regulation and the changing regulatory environment.

³Australian Bureau of Statistics 2007, *Counts of Australian Businesses, including Entries and Exits, December (Cat No. 8165.0)*.

Identify costs and benefits

Costs and benefits of each proposed option can include compliance costs, economic impacts, social impacts and environmental impacts. Thoroughly understanding costs and benefits is a key element of applying the better regulation principles.

- **Compliance costs** are the direct cash flow effects of a regulatory requirement. These costs relate to capital and production costs and administrative requirements. Examples include developing and maintaining reporting systems, obtaining professional advice, educating or training staff about new regulatory requirements and procedures, purchasing equipment or changing production processes and other activities involved in complying with regulation.
- **Economic impacts** affect the allocation of resources, productivity, competition and innovation. Other economic impacts include opportunity costs (i.e. the benefits that would have been received from other options which will not be realised by the preferred option) and externalities (the costs or benefits arising from a transaction that do not accrue to either party to the transaction).
- **Social impacts** include such considerations as quality of life, equity, achieving community norms, ensuring public health and safety, reducing crime and protecting human rights. While many of these impacts have a financial dimension, the full impacts are more difficult to quantify than pure financial and economic impacts because they often do not have a market value.
- **Environmental impacts** like improvements to air quality for example, can also be difficult to quantify in dollar terms because they are not traditionally valued in the marketplace but should be taken into account in any impact assessment process.

The information required to estimate impacts can come from a range of sources, including consultation with businesses, industry associations and peak bodies and surveys or data from organisations such as the Australian Bureau of Statistics.

Both the direct and indirect impacts of options must be considered. Direct impacts are those clearly related to the purpose of an option. Indirect impacts are incidental to the main purpose and may affect parties other than those targeted by the option.

Consider any competition restrictions

Regulatory proposals should be assessed using the NSW Government's Assessment Against the Competition Test, available at www.betterregulation.nsw.gov.au, which is consistent with the *Competition Principles Agreement 1995*⁴. The competition test specifies that regulation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction as a whole outweigh the costs, and
- the objectives of the legislation can only be achieved by restricting competition.

An option is likely to restrict competition if:

- it affects the market structure of the regulated industry
- it creates barriers to firms entering or exiting the industry
- the impacts of the option affect some stakeholders significantly more than others
- it restricts the ability of businesses to choose the price, quality, range or location of their products
- there will be higher ongoing costs for new entrants compared to existing players, or
- it inhibits innovation or the development of new products or services.

⁴The *Competition Principles Agreement* is one of three intergovernmental agreements that underpin the National Competition Policy (NCP). The three agreements outline the reforms which governments undertook to put in place under the NCP process. For further information see: National Competition Council (2nd edn.), 1998, *Compendium of National Competition Policy Agreements*, p 13–23, www.ncc.gov.au

The assessment of competition impacts should be proportionate to the likely impact of the policy option on competition. Where there is only a minor impact, a simple assessment will suffice but where there is a significant impact, then a more detailed assessment should be provided.

Evaluate costs and benefits

Estimating the net impact of an option involves assessing each of the costs and benefits of the option. Costs and benefits can be compared across key stakeholder groups and the net impacts can be compared between the options.

The level and depth of quantitative analysis applied should depend on:

- the significance of the problem and the impacts of proposed options
- the type of impacts and the availability of data on costs and benefits (financial and economic impacts can be more readily quantified than social or environmental impacts), and
- the techniques available to reliably quantify costs and benefits.

Wherever possible, quantitative or dollar values for costs and benefits must be determined. This allows for clearer comparison both across and between options, and supports independent validation of the results.

There are several methods and tools which can be used to quantify costs and benefits. Agencies are encouraged to employ the methodology most appropriate to their circumstances, and a level of effort in proportion to the significance of the issue.

A guide to assist agencies to measure the costs of a regulatory proposal, *Measuring the Cost of Regulation*, is available at www.betterregulation.nsw.gov.au.

Table I provides examples of the types of costs and benefits associated with regulatory options for different groups within society. **Appendix C** provides detailed information on the use of quantitative and qualitative methods to determine the costs and benefits of proposals, along with worked examples showing how impacts can be quantified in practice.

Table I: Examples of costs and benefits of regulation for different groups

Group	Example of Cost	Example of benefits
Businesses	<p>Quantifiable</p> <ul style="list-style-type: none"> • administrative costs, including time, associated with complying with and reporting on regulatory requirements • licence fees or government charges • changes to procedures required as a result of the measure (eg production changes or higher input costs) <p>Qualitative</p> <ul style="list-style-type: none"> • innovation stifled 	<p>Quantifiable</p> <ul style="list-style-type: none"> • increased efficiency or productivity • reductions in workplace accidents and injuries • reductions in compliance costs <p>Qualitative</p> <ul style="list-style-type: none"> • better market information and certainty • improved competitiveness • better conditions for innovation
Consumers	<p>Quantifiable</p> <ul style="list-style-type: none"> • higher prices for goods and services <p>Qualitative</p> <ul style="list-style-type: none"> • reduced choice, quality or availability of goods and services • delays in goods coming on the market and obtaining services • needs not met 	<p>Quantifiable</p> <ul style="list-style-type: none"> • lower prices • improved safety of products <p>Qualitative</p> <ul style="list-style-type: none"> • quality and choice of goods and services • availability of better product information • needs and preferences met
Government	<p>Quantifiable</p> <ul style="list-style-type: none"> • regulation set up costs • compliance activities • collection of information and record keeping • administration of regulatory instruments 	<p>Quantifiable</p> <ul style="list-style-type: none"> • better information • licence fees • reductions in administrative costs • improved economic outcome
Community and the environment	<p>Quantifiable</p> <ul style="list-style-type: none"> • taxes, licence fees and charges • lower employment levels • increased paperwork <p>Qualitative</p> <ul style="list-style-type: none"> • inequitable distribution of wealth 	<p>Quantifiable if possible, otherwise qualitative</p> <ul style="list-style-type: none"> • better environmental health • better public health and safety • reductions in crime and anti-social behaviour • increased leisure time • economic growth

Identify the recommended option

Once the regulatory impact assessment is completed, the relative merits of different options considered should be compared. The assessment should take into account the results of quantitative and qualitative analysis, distributional impacts, any cumulative regulatory burden, and risk and uncertainty.

The recommended option should be identified with an explanation of why it is the preferred option, reasons for rejecting other options and the main assumptions used in the analysis.

Quick reference guide – ASSESSING IMPACTS

- Is the level and detail of the assessment of costs and benefits proportionate to the size of the problem and the potential impacts of options?
- Have all groups affected by proposed options been identified, including sub-groups?
- Have financial, economic, social and environmental impacts been identified, including both direct and indirect costs and benefits?
- Has the most appropriate method of assessment of each option been considered, taking into account availability of data, ability to quantify costs and benefits, and the significance of the impacts?
- Have distributional impacts, cumulative regulatory burden, and risk and uncertainty been considered in the analysis?
- Have any competition restrictions resulting from options been identified and justified?
- Have compliance costs to business been assessed?
- What is the recommended option, based on meeting objectives and achieving the greatest net benefit or least cost to the community?

Develop a plan for implementation and compliance

An implementation and compliance strategy should be developed for the preferred option to ensure the objectives will be effectively and efficiently achieved. This is an important part of the process, as even a well designed regulatory solution can impose unnecessary administrative or compliance costs if it is not implemented well. Planning can help to achieve the greatest level of compliance at the lowest possible cost.

Features of an effective compliance assurance strategy include:

- identifying the regulated community
- identifying roles and responsibilities, including resources required and sources of funding
- establishing program priorities, using a risk-based approach
- promoting compliance, including providing assistance such as guidance and working with co-regulators
- monitoring compliance, using tools such as self-reporting, inspections, audits, complaints, and
- enforcement response to non-compliance, using tools such as orders, notices and prosecutions.

A risk-based approach to compliance means targeting compliance efforts towards those players who pose the highest risk. A hierarchy of compliance tools from information, education and guidelines through to enforcement action like fines should be used to tailor compliance activities to the risks involved. For example, where there are sectors of the community seeking to comply with regulations and who pose a low risk, actions to assist compliance such as education and guidance may be most effective.

More punitive enforcement measures may be needed for groups with little incentive to comply and where the consequences of non-compliance are more severe. The penalties should be explained clearly in the strategy.

Well targeted implementation and compliance activities should be supported by the collection of data which can help identify and target problems or non-compliance and can assist with ensuring a more proportionate regulatory and compliance response. A transparent decision making, recording and reporting framework is also integral to effective implementation of regulatory reforms.

A guide to assist agencies to implement a risk-based approach to compliance, Risk-Based Compliance, is available at www.betterregulation.nsw.gov.au.

Quick reference guide – IMPLEMENTATION

- Does the implementation strategy clearly set out how the proposal would be implemented and enforced?
- Does the strategy communicate the purpose and objectives of the proposal?
- Are roles and responsibilities clearly defined in the implementation strategy?
- Does the implementation strategy set out regulatory requirements and actions needed for compliance?
- Are compliance burdens imposed consistently across different groups?
- Are compliance burdens commensurate with the size of the problem?
- Are compliance strategies and penalties explained in the implementation strategy?

Consider how performance will be monitored and reported

The Government is committed to more robust performance monitoring by agencies. The traditional measures of compliance success such as the number of proceedings launched or the level of penalties imposed give some indication of the outcome of compliance activities. However, they may not give a clear picture of whether the objectives of the regulation are being achieved.

These types of measures also fail to provide information on whether the implementation of the regulation is effective and efficient. Poor implementation can contribute significantly to the costs and administration burdens imposed on business and the community.

It is important that agencies develop performance indicators based on the objectives of regulations. Such ‘outcomes’ based performance indicators should be reported alongside the more traditional ‘output’ or process-based indicators like the timeliness of decision making and approval processes and indicators of compliance and enforcement activity.

Agencies should also routinely monitor the performance of regulation by collating and analysing queries or complaints from the public, external stakeholders and internal government officers.

Principle 4: Government action should be effective and proportional

Effective government action will ensure regulation achieves its objectives without imposing unnecessary costs. The scope of the regulatory proposal should be proportionate to the seriousness of the problem being dealt with.

In keeping with this principle, the amount of time, effort and other resources spent developing any regulatory proposal should also be proportionate to its importance and its impact. This is an overarching principle and should be applied at all stages of the regulatory development process. The effort spent on a regulatory proposal should be considered in terms of the:

- significance of the problem and associated risks
- scope of consultation required, including timeframes and stakeholders
- appropriate level of detail needed to understand the impacts, including the measurement of compliance costs, and
- need to include compliance and reporting procedures.

Quick reference guide – PROPORTIONALITY

- Is the scope of the regulatory proposal proportionate to the seriousness of the problem being dealt with?
- Is the amount of time, effort and other resources spent developing the regulatory proposal proportionate to its importance and its impact?

Principle 5: Consultation with business and the community should inform regulatory development

The Government is committed to consulting on all regulatory proposals. Consultation should be applied at all relevant stages of the regulatory development process.

The minimum consultation period on draft regulations is 28 days although this does not prevent longer consultation periods being employed for more significant or complex proposals, or where otherwise appropriate to the stakeholders or issues concerned.

Consultation may be necessary at a number of different points during a regulatory development process. Conducted early in the process, it can help to properly identify a perceived problem and determine viable regulatory or non-regulatory options to deal with it. Consultation can help government fully understand all the risks and impacts of regulatory proposals and help identify any unintended consequences of those proposals. Both government and stakeholders should understand that consultation does not always lead to consensus, as governments often need to balance competing considerations when deciding on the best option to follow.

The Government's **consultation policy** on regulation making should be followed when developing regulatory proposals and is available at www.betterregulation.nsw.gov.au.

Quick reference guide – CONSULTATION

- Is consultation planned to occur throughout the regulatory development process?
- Does the consultation period allow stakeholders adequate time to prepare responses?
- Is the approach to consultation commensurate with the size of the problem to be addressed, the significance of the impacts of the proposal and the stakeholder concern about the policy issue?
- Will all stakeholders that may be affected by the options be consulted?

Principle 6: The simplification, repeal, reform or consolidation of existing regulation should be considered

The Government has made a commitment to simplify, repeal, reform or consolidate existing regulation, rather than adopting a 'one in, one out' rule. This principle should be considered in all regulatory development processes, including amendments to existing regulations. This will help ensure:

- new regulation is necessary and consistent with existing regulation
- existing regulation is repealed where new regulatory proposals supersede it
- the use of existing instruments or regulation has been considered, and
- the administrative and compliance burden of regulation is reduced.

To reduce compliance costs, it is important to ensure all regulation which covers the same area works effectively and efficiently and without duplication. Unnecessary layers of regulation should be repealed and regulatory instruments should be consolidated wherever possible.

There may be opportunities for 'offsetting' new regulation. For example, where a proposal would impose an additional reporting burden on business, this may provide an opportunity to update or repeal existing reporting requirements that are outdated or redundant.

Harmonisation with other jurisdictions should also be considered.

Quick reference guide – SIMPLIFYING EXISTING REGULATION

- Does the new proposal make other regulatory requirements obsolete which can now be repealed?
- Does the new proposal fit with existing regulatory requirements?
- Can the policy objectives be achieved by 'piggy-backing' on an existing regulatory instrument?
- Is it feasible to consolidate the requirements in a number of instruments into a single regulation?
- Can reporting requirements imposed under existing approvals, licences or regulatory instruments be simplified or repealed?
- Is existing regulation still valid?

Principle 7: Regulation should be periodically reviewed, and if necessary reformed to ensure its continued efficiency and effectiveness

The Government has committed to a program of ongoing review of all regulation unless it has a minimal impact. Apart from such cases, a review clause should be included in all Bills. Statutory rules will continue to be reviewed under the provisions of the *Subordinate Legislation Act* every five years.

Reviews should generally be conducted after five years, although a longer review period may be warranted for example, where the impact of the regulation is minor and the policy is well settled. For regulation where an extended period of certainty is required, for example where regulation sets the framework for major private sector investment, longer review periods may also be justified.

In other cases reviews may be held after shorter periods. For example, a review should be considered within two to three years where a regulatory scheme is contentious, has a potentially significant impact or cost, or where there is considerable uncertainty about how it will operate in practice.

Most reviews should consider:

- whether the policy objectives of the regulatory scheme remain valid
- whether the terms of the regulatory scheme remain the most efficient way to achieve those objectives with the least impact, and
- whether the regulatory scheme is being implemented and enforced in the most efficient manner with the least administrative burden and cost impacts necessary.

After the first review, a new review clause should be added when principal legislation is amended.

Quick reference guide – REVIEW

- Have monitoring and review requirements been included in the regulatory proposal?
- Does the review strategy take into account the form and content of regulation?
- Can a group of regulatory instruments be reviewed together to increase the effectiveness and efficiency of the review process?
- Does the planned type and frequency of reviews reflect the significance and scope of impacts, complexity of the regulation and the impacts of reviews on affected parties?



Preparing a Better Regulation Statement

What is a Better Regulation Statement?

A Better Regulation Statement must be prepared for all **significant** new and amending regulatory proposals. It must demonstrate that a significant regulatory proposal is justified by documenting the analysis undertaken to apply the better regulation principles.

The purpose of a Better Regulation Statement is to provide:

- decision makers with sufficient information to enable them to make an informed decision about whether to approve the proposal. An important element is demonstrating that the impacts of the proposal, including compliance costs, are well understood. Wherever possible, the assessment must be supported by quantitative analysis, and
- business and the community with information about decision making, ensuring transparency and accountability in the regulatory development process.

A Better Regulation Statement should be a succinct, stand alone document. Depending on the nature of the regulatory proposal, it might only be 6 pages long, for example. Other proposals may require more detailed explanation. The preparation of a Better Regulation Statement should not require external consultants.

How to submit a Better Regulation Statement

If a Better Regulation Statement is required for a regulatory proposal, it should be submitted to Cabinet Secretariat with the Cabinet Minute or Executive Council Minute.

The timetables for submission to the Cabinet Secretariat remain the same for Cabinet Minutes (10 days before the Cabinet Meeting) and Executive Council Minutes (noon on the Friday before the Executive Council Meeting). However, agencies are encouraged to seek early feedback from the Better Regulation Office on regulatory approaches and draft Better Regulation Statements to avoid delay.

Approval process for Better Regulation Statements

The Minister for Regulatory Reform approves Better Regulation Statements.

The Better Regulation Office examines Better Regulation Statements and advises the Minister on whether they demonstrate that the better regulation principles have been applied in the development of a regulatory proposal.

If a Better Regulation Statement does not demonstrate compliance with the better regulation principles, the Minister for Regulatory Reform may refuse approval. In such cases, the Minister will advise the Premier that the matter should not proceed to Cabinet or to the Executive Council until the concern is resolved.

If the Premier agrees with this advice, the proposal will be deferred until compliance can be demonstrated. This may involve amending the Better Regulation Statement to provide additional information, undertaking additional analysis or consultation to ensure the option which has been chosen can be justified or considering an alternative option.

A copy of the Minister for Regulatory Reform's advice to the Premier will be circulated to the portfolio Minister prior to Cabinet. As noted above, agencies are strongly encouraged to seek advice from the Better Regulation Office prior to formal submission of a Better Regulation Statement to avoid delay. The Better Regulation Office will advise agencies if it provides 'in-principle' approval of the Better Regulation Statement.

Publishing Better Regulation Statements

Better Regulation Statements must be made publicly available, except in limited cases determined by Cabinet.

Better Regulation Statements must be made publicly available by the relevant agency on their website as soon as practicable after a Bill is introduced into Parliament, or after a regulation is published on the NSW Government legislation website at www.legislation.nsw.gov.au. Statements should remain on agency websites while the regulation is in force.

Better Regulation Statement template

The following structure of a Better Regulation Statement has been provided as a guide only. While all of the better regulation principles need to be addressed, agencies can use their discretion in respect to structuring this information and should only use the elements which are relevant to, and best support, the proposal.

1. Executive summary (Principle 4)

Provide a summary of the proposal and a short justification for why the preferred option is recommended.

- Demonstrate that the proposed regulatory approach is proportionate to the policy problem.
- Outline the consultation approach adopted and provide a brief summary of stakeholder views of the proposal.
- Demonstrate that the preferred option provides the greatest net benefit or least cost to the community.

2. Need for government action (Principle 1)

Demonstrate that government intervention is justified.

- Clearly identify and provide evidence of the policy problem.
- Advise whether consultation was used to help identify the problem.
- Explain the actual or potential impacts of not taking action and summarise the outcome of any risk analysis.

3. Objective of government action (Principle 2)

Demonstrate that the objectives of government action are well understood.

- Clearly describe the objectives of the proposal.
- Ensure the objectives are consistent with existing government policies.

4. Consideration of options (Principle 3 and Principle 6)

Outline the various options that were considered in developing the proposal.

- Ensure the status quo is considered as an option.
- Consider non-regulatory alternatives.
- Show opportunities to simplify, repeal, reform or consolidate existing regulation have been considered and acted on.
- Show any opportunities for national or cross border uniformity or harmonisation have been pursued.
- Outline if stakeholders have been consulted in the development of options.

Outline the costs and benefits of these options. This is a very important part of the Better Regulation Statement and must be comprehensive. The aim is to demonstrate that the potential impacts of the proposal are understood. Where possible, impacts should be quantified. For some aspects of a regulatory proposal, qualitative assessment may be appropriate. The method of assessment should reflect the significance of the proposal and likely impacts. A detailed analysis of the costs and benefits is not needed for options that are clearly less optimal, for example, those that will not meet stated objectives or are prohibitively expensive for businesses to comply with.

While every proposal is different, it is recommended that the following be addressed:

Compliance costs

- Identify the potential costs of the regulation on business.
- Outline the compliance issues raised during consultation.
- Costs should include resources, time and financial costs likely to be incurred by business⁵.
- Identify any particular impacts on small business.

Administrative costs

- Identify potential costs on government that will be incurred from implementing the options.
- Identify time constraints on government.

Competition impacts

- Identify potential competition restrictions that may result from each option.
- Identify potential impacts on innovation.

Other costs

- Identify direct and indirect costs and benefits.
- Identify any social costs or impacts on community.
- Identify any environmental impacts.
- Identify any distributional impacts across regions.
- Identify any cumulative impacts of the regulatory options.

Implementation and compliance

- Demonstrate how the preferred option will be implemented and enforced.
- Identify roles and responsibilities for implementation and compliance.
- Outline compliance strategies and penalties.

5. Consultation (Principle 5)

Demonstrate that consultation was conducted in a way which informed the development of the options considered, as well as the determination of the final regulatory proposal.

- Show how consultation helped to identify the problem, understand the impacts of the options and inform the selection of the preferred option.
- Provide information on which stakeholders were consulted, when consultation occurred, matters on which input was sought and the time period for comment⁵.
- Describe the central themes arising during consultation and key areas of support and dispute.
- Describe how the proposal addresses the major concerns raised in the consultation process.

6. Preferred option (Principle 3 and Principle 4)

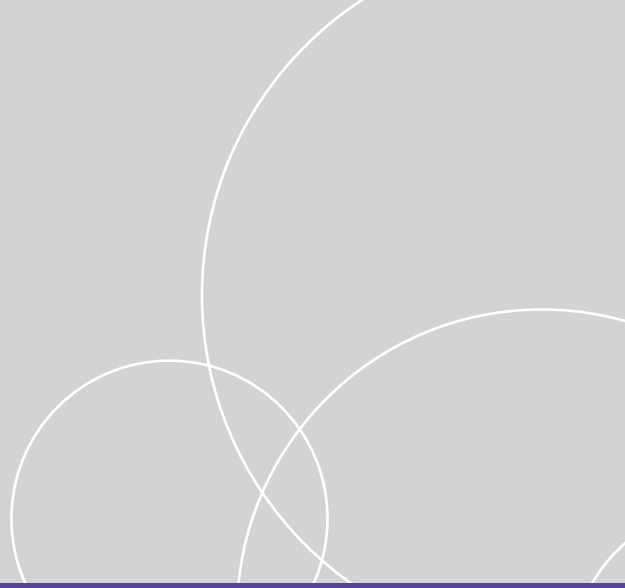
- Identify the preferred option.
- Justify the preferred option based on its ability to meet the objectives and achieve the greatest net benefit or least cost to the community.

7. Evaluation and review (Principle 7)

- Identify the monitoring strategy for the performance of the regulatory proposal and show why this strategy is appropriate.
- State when a review of the policy objectives will be undertaken, and explain any divergence from a review period of five years.
- Where relevant, given the likely impact and complexity of the regulation and the impact on stakeholders, report on whether the regulation should be reviewed with other instruments, and whether any specific elements should be reviewed at an earlier time.

⁵*It is not expected that all impacts will be reported in financial terms. This should be done where sensible and appropriate to the regulation being proposed. For example, it would be appropriate to estimate the dollar costs where a new regulatory requirement requires a specific capital investment. Where new operational requirements or reporting processes are proposed, it may be more sensible to estimate the number of additional staff or work hours required to comply with the regulation*

⁶*A minimum consultation period of 28 days is required*



Appendices

Appendix A: Market failure

Competitive markets:

- provide the most efficient means of allocating resources to maximise the benefits to the community
- ensure the goods and services that consumers demand are produced efficiently, and
- encourage innovation and broader consumer choice.

'Market failure' has a very precise meaning in economics. It does not simply mean dissatisfaction with market outcomes. It refers to a situation when a market left to itself does not allocate resources efficiently. Where market failure exists, there is a potential role for government to improve outcomes for the community, the environment, businesses and the economy.

Governments may intervene to change the behaviour of businesses or individuals to address market failure or to achieve social and environmental benefits that would otherwise not be delivered. Government intervention is not warranted in every instance of market failure; in some cases the private sector can find alternative solutions. The four main types of market failure are outlined below.

Public Goods

Public goods exist where provision of a good (product, service, resource) for one person means it is available to all people at no extra cost. Public goods are therefore said to be 'non-excludable' and 'non-rival'.

Free-riding is a problem with public goods. Because the good is non-excludable, everyone can use it once provided. This makes it impossible to recoup the costs of provision by extracting payment from users.

The definition of a public good should not be confused with phrases such as 'good for the public', 'public interest' or 'publicly produced goods'. There are very few absolutely public goods. Examples include national defence, law enforcement, clean air, street lights and flood control dams.

There may be a role for government in providing public goods or funding private provision. However, such intervention should only take place where it is clear the market would not find a solution to this form of market failure. Government intervention should not stifle private innovation.

Externalities

Externalities are costs or benefits arising from an economic transaction received by parties not involved in the transaction. Externalities can be either positive (external benefit) or negative (external cost). The existence of externalities can result in too much or too little of goods and services being produced and consumed than is economically efficient. For example, where the cost of producing a good does not include its full costs, say in relation to environmental damage, then a negative externality is said to exist. This results in the good being over-produced (and under-priced).

The government may try to address negative externalities through:

- regulation that mandates corrective measures
- persuasion (eg an advertising campaign to 'Do the right thing' and not litter)
- establishing property rights in the externality, and
- charging for pollution generating behaviour.

Goods associated with positive externalities are sometimes termed 'merit goods'. Governments may have a role in encouraging increased consumption of merit goods through subsidisation of or public provision of such goods (eg free access to vaccinations). Mandating consumption is a regulatory alternative (eg compulsory schooling for all children).

Information Asymmetry

Information asymmetry occurs when one party to a transaction has more or better information than the other party. Typically, it is the seller that knows more about the product than the buyer; however, it is possible for the reverse to be true. Information asymmetry can prevent consumers from making fully informed decisions.

Regulation requiring information disclosure or placing restrictions on dangerous goods can be used to address this type of market failure. For example, when providing financial advice, financial service providers are required to disclose information about significant benefits and risks, and the fees and charges associated with the financial products, as well as remuneration they receive in relation to the services offered.

It should be noted, however, that information disclosure alone may not be sufficient to change behaviour where there is information asymmetry. Behavioural economics suggests that individuals do not always make decisions in their best interests based on the information provided. It may be necessary to use other instruments in conjunction with providing information to overcome this market failure.

Imperfect Competition and Market Power

Market power exists when one buyer or seller in a market has the ability to exert significant influence over the quantity of goods or services traded, or the price at which they are traded.

In perfectly competitive markets, market participants have no market power. The ability of an incumbent firm to raise its price above competitive levels is limited by the existence of or threat of competition.

The existence of market power can result in economic inefficiency because it may:

- allow firms to increase prices without a commensurate reduction in demand, and
- restrict competition by creating barriers to entry by other firms.

Examples of market power include monopoly (where there is a single supplier) and oligopoly (where a small number of firms control the market). Where market power exists, governments may intervene to correct the operation of the market or set prices at a competitive level.

Appendix B: Non-regulatory & regulatory options

Taking no action or maintaining the status quo

The option that maintains the status quo should always be considered. Taking no action may be the best response if the cost of action would be greater than the costs of the problem. Even if it is not, exploring this option establishes a base against which other options can be compared. The status quo can reflect an environment with no regulation or one that is already regulated.

A review of the current state of affairs may identify ways to improve the effectiveness of existing instruments to achieve policy objectives at low cost. It may also highlight previous regulation that has caused or exacerbated the problem. It may be possible to amend existing instruments to expand their coverage, remove flaws, improve compliance or strengthen enforcement. If a new approach is needed, the existing regulation may need to be repealed or consolidated.

Non-regulatory instruments

If it has been determined that there is a need for government action, the starting point should be a non-regulatory approach. Some policy problems may be more efficiently or effectively addressed by the market or by individuals acting without government involvement.

Non-regulatory approaches are options to deal with a policy problem that do not involve government intervention to direct the actions of people or organisations. It is important to consider non-regulatory options because these often have lower costs and less impact on markets than regulatory options. Stakeholders should be consulted to help determine whether a non-regulatory approach might be appropriate in a given situation. Types of non-regulatory approaches include:

- provision of information
- self-regulation
- quasi-regulation, and
- co-regulation.

Provision of information

When sellers have information that is not available to buyers (information asymmetry), government intervention may be justified. Without access to information, buyers may make decisions that have negative social consequences (for example, buying dangerous cars, eating an unhealthy diet or investing in businesses that are hopelessly in debt). An information based strategy that educates can be the best way to remedy these kinds of problems.

One type of information based strategy is publication by the Government. For example, the US Department of Transportation publishes the ontime record of commercial airlines. This not only gives airlines an incentive to keep to their schedules, it also encourages them to publish a realistic schedule in the first place. By publishing such data, the Government acts as a neutral referee.

An information based strategy preserves consumer choice. Even poorly informed consumers have a lot of information that governments do not about their preferences, their financial situation, their skills etc. Governments on the other hand can provide critical information for consumers by buying expertise or testing resources. It can be easier and more effective for the Government to pass on relevant information to inform decisions by consumers than vice versa.

Another variation of an information based strategy is 'persuasion', in which governments seek to leverage values of good citizenship, good corporate behaviour, self preservation or peer pressure to achieve public ends. However, this approach has an inherent 'free rider' problem and may only be effective where

individuals or businesses are morally sensitive or have low compliance costs. Sometimes, this option may be effective when used in conjunction with other instruments.

Information based strategies may not always lead to the outcome intended by Government. In these circumstances, the strategy may not be ineffective; consumers may simply have a different view to the Government about what is in their best interest. It may be time to rethink the rationale for government action. If consumers have all the information they need and price signals are accurate, then an information based strategy is likely to be a viable option.

Example of an information campaign – NSW Health ‘Go for 2 & 5’ campaign

The ‘Go for 2 & 5’ campaign, being implemented by NSW Health, the Cancer Institute NSW and Horticulture Australia, aims to reduce health problems caused by poor diet. The campaign recognises that some of these problems are caused by a lack of knowledge about the benefits of healthy eating.

The ‘Go for 2 & 5’ campaign focuses on increasing fruit and vegetable intake to two serves of fruit a day and five servings of vegetables (the recommended adult intake for good health). If successful, the campaign may significantly reduce health care costs by helping to prevent diabetes, heart disease, obesity and other chronic illnesses.

The campaign involves providing information through a number of media, including television and radio advertising, a web site, and a series of publications in 11 languages. It also includes in-store promotions in major supermarkets across NSW such as trolley ads, recipe cards, tastings and product sampling.

Mandatory information provision

Information strategies are sometimes based on a regulation that mandates disclosure directly from sellers to buyers. For example, regulations may require the meaning of words such as ‘fresh’ or ‘lite’ to be defined or that the results of standardised tests, such as energy efficiency ratings be disclosed.

Mandatory information disclosure can be costly. Often, the administrative burdens of collecting and maintaining information are very great. Sometimes the mandated information turns out to be more confusing than helpful to consumers. But where disclosure strategies are expected to achieve the goal of informed consumer choice, they can be much less costly than alternatives that set mandatory standards.

Self-regulation

Self-regulation uses industry development of voluntary rules or codes of practice, with the industry in question solely responsible for compliance. The Government usually has no role under this form of regulation although in some cases it may provide information or advice.

Effective voluntary industry self-regulation can generate benefits for industry, the consumer and for regulators. Self-regulation can be effective where there is a cohesive industry association that is representative of the industry. Compliance with the voluntary rules may be a condition of membership of the association.

Self-regulation will only be effective if the industry is committed to making it work. Where this is not the case, there will be costs imposed on the community without the offsetting benefits.

Example of self-regulation – Supermarket Scanning Code

The Supermarket Scanning Code was developed to protect the interests of customers in the operation of supermarket scanning systems. The Code is voluntary and applies to supermarkets and food stores who are signatories to it, currently including: Woolworths Supermarkets; Coles Supermarkets; Bi-Lo Supermarkets; and Franklins.

Under the Code, supermarkets are required to ensure the price accuracy of their checkout systems and self-pricing procedures. When an error occurs the customer could be entitled to that item free of charge.

The Australian Competition and Consumer Commission sees the Code as a positive step by the industry to implement self-regulation to gain fair trading outcomes, prevent disputes and to introduce a mechanism to deal with disputes when they arise.

Quasi-regulation

Quasi-regulation refers to the range of rules, arrangements or standards which governments pressure businesses to comply with but which are not legally binding. Quasi-regulation can include industry codes of practice which the government has endorsed but is not responsible for enforcing, negotiating directly with industry on agreed standards of behaviour, or making compliance with such codes or agreements necessary in order to compete for government contracts or funding. This type of regulation may be useful where an industry specific solution to a problem is required.

Co-regulation

Co-regulation typically refers to the situation where an industry or professional body develops the regulatory arrangements in consultation with a government. While the industry administers its own arrangements, the Government provides legislative backing to enable the arrangements to be enforced.

Example of co-regulation – Industry code for motor vehicle repairers and insurers

The Code was developed collaboratively by the motor vehicle repair industry and the insurance industry to promote transparent and cooperative relationships between smash repairers and insurance companies.

The Code applies to all motor vehicles that are repaired in NSW, irrespective of where they are registered, but does not apply to motor vehicles owned or used by repairers. The Code covers the major aspects of the relationship between repairers and insurers, including network smash repairer schemes, the estimation, authorisation and repair process, repair warranties, payment terms, disclosure obligations and the dispute resolution process. The Code provides for mediation between repairers and insurers for disputes over the repair process or a failure to comply with the Code.

The Code was developed as a voluntary national code. The NSW Government decided to mandate the Code from March 2007 to ensure that the standards it puts into place can be enforced. *The NSW Fair Trading Act 1987* was amended to require insurers and repairers to comply with the Code. Failure to comply is a breach of the Act and may lead to action being taken under the Act for compensation or other orders made against the party contravening the Code.

Creating Markets or Developing Market Based Instruments

Market based instruments are an alternative to prescriptive regulation that create economic incentives to achieve policy objectives. Market based instruments can minimise the cost to society of achieving policy outcomes. They recognise businesses may innovate to find ways to achieve the outcomes which have been established, rather than prescribing the ways in which businesses must operate. Market based instruments are particularly useful in dealing with externalities from private activities when free markets lead to too little or too much production of a particular good or service.

Examples of market based instruments are discussed below and include:

- creating markets in tradeable property rights
- imposing government charges
- providing government subsidies, or
- creating financial liability to encourage firms to take precautions.

Creating markets in tradeable property rights

This type of instrument assigns property rights to resources, activities or undesirable outcomes of production such as pollution and then creates trading schemes to allow them to be traded in the marketplace. They use dynamics already present in the marketplace to achieve the desired result. Trading schemes can be particularly useful where activities create significant externalities or require access to public resources such as fish stocks or water.

Example of tradeable property rights – Hunter River Salinity Trading Scheme

Market based instruments can minimise the impact of regulation by using economic incentives to businesses to modify their behaviour. The Hunter River Salinity Trading Scheme (HRSTS) is a licensing scheme for discharges of saline water in the Hunter River catchment in NSW. The objective of the scheme is to minimise the impacts of salinity in the river catchment by limiting discharges of saline water by heavy industry.

Each participant in the HRSTS holds a number of 'salt credits' entitling them to discharge a share of the total allowable discharge on any day. Credits may be traded between participants so that those holders who do not need to discharge can sell their entitlement to others with the greatest need.

Through trading, the overall costs of saline water management are minimised while compliance with scheme rules guarantees that water quality goals are never compromised by discharges.

Imposition of government charges

Charges can be useful where resources are under-priced due to the existence of externalities or where they are not priced at all, for example, access to clean air. Corrective charges on resources that are priced too low may improve the efficiency of the economy by assigning prices to the use of otherwise unpriced (but not zero-cost) resources.

Charges can encourage the economically efficient allocation of resources. They can help to encourage innovation through encouraging the adoption of the use of efficient technologies and methods of compliance. Generally they have low enforcement costs.

It can, however, be difficult to estimate the precise quantum of the charge required to achieve the desired behavioural response and policy outcomes.

Example of charges and subsidies – the Parking Space Levy

The NSW Government's Parking Space Levy is paid by owners of non-residential parking spaces in declared areas within Sydney's major commercial centres. The levy was introduced to discourage car use in congested areas, encourage the use of public transport and to improve air quality.

All revenue from the levy is used to fund the construction of projects which make it easier and more convenient for people to access public transport services. These include building and maintaining bus, rail and ferry interchanges, commuter car parks, bus shelters, taxi stands, kiss and ride facilities, bicycle lockers, light rail systems and better passenger information and security systems.

To the extent that the levy is passed on as higher costs for parking within these areas, it sends a signal to car owners about the value of scarce space and may provide an incentive to use public transport, particularly if these services are improved via the revenue raised from the levy.

Providing government subsidies

Government subsidies can be used to reduce the financial costs to industry or to the community of complying with government requirements where the policy outcomes sought will provide significant social benefits or where a market is not yet established. Well designed subsidies can provide incentives for innovation and the development of cost effective solutions.

For example, the NSW Government has established the Water and Energy Savings Fund to assist businesses to pay for sustainable and cost effective projects to reduce water and energy demand. Often the additional government funding needed to make these projects viable is much less than the cost to government of implementing alternative programs to achieve the same objectives.

Creating financial liability

This approach is often used to deal with behaviour that may have significant impacts on the environment and can ensure that the costs of environmental damage or rehabilitation are not borne by the wider community. By placing responsibility for restoration of the environment or compensation for environmental damage on the polluter, the economic incentives associated with engaging environmentally risky behaviour are changed.

Example of financial liability – performance bonds

Performance bonds are often used in the mining industry, where resource extraction companies are required to set aside funds to pay for the clean-up of environmental damage caused by their operations. The funds are independently held and refunded when compliance with environmental requirements is achieved. Performance bonds can provide an incentive for mining companies to use less environmentally damaging approaches to extraction in the first place if they cost less than the amount paid for the bond.

A combination of instruments

Sometimes policy problems are best addressed through a combination of regulatory instruments and non-regulatory approaches. This may improve effectiveness of regulation by better targeting tools to achieve compliance.

Regulatory approaches can be combined in a number of ways. In some cases, tools may be used simultaneously to improve compliance. For example, to achieve reductions in health problems caused by cigarette smoking, a combination of economic instruments (Commonwealth excise to increase the price of cigarettes), legislation (forbidding the sale of cigarettes to children and prohibiting smoking in certain places) and information campaigns (advertising and warnings on packets) has been used.

Alternatively, a range of instruments can be used in the implementation and enforcement of regulation. For example, the NSW Department of Environment, Climate Change and Water uses a range of responses for breaching provisions of the *Protection of the Environment Operations Act 1997*, including warnings, clean-up notices, pollution reduction programs that become binding through licence conditions, and prosecution as a last resort.

Performance Based Versus Prescriptive Regulation

The different regulatory approaches form part of a continuum, ranging from performance based options which specify desired outcomes or objectives but not the means by which these outcomes must be met,

through to prescriptive rules that focus on inputs, processes and procedures and generally impose punitive sanctions (such as fines or even custodial sentences) or remedies (such as statutory warranties, access to compensation or dispute resolution) for non-compliance.

Prescriptive regulatory instruments are likely to be more justifiable where a high level of certainty is required and where the risks associated with non-compliance are high. This type of regulation can provide greater consistency and clarity of expectations. However, it can also lock in inefficient practices and inhibit innovation. If regulation is overly prescriptive, it can increase compliance costs and the regulatory burden.

Performance based alternatives which allow business to determine how it will meet performance standards can be more flexible and encourage innovation. This approach is particularly important where rapid change is being experienced, for example, with fast paced technological advances. Performance based regulatory schemes can also be cheaper to implement and/or administer than prescriptive regulation. However, it is important to consider the full range of impacts as compliance can be more difficult than for prescriptive regulation.

Performance based regulation can also be difficult to develop, as it can require detailed specification and measurement of desired outcomes, which are not always apparent. Similarly, it may require the development of operational guidance to provide adequate understanding and knowledge of the requirements to ensure compliance. This may present a greater impost on smaller businesses in relation to developing the necessary compliance strategies. In these cases, consideration should be given to deemed compliance provisions that smaller businesses can rely on if they choose.

Appendix C: Assessment of cost & benefits

This appendix provides more detail on alternative methodologies to assess costs and benefits. As many of these methodologies are resource intensive, they should generally be applied when the impacts or risks of a proposal are large.

When assessing the impacts of a regulatory proposal, agencies should also refer to *Measuring the Costs of Regulation*, available at www.betterregulation.nsw.gov.au.

Cost Benefit Analysis

Cost benefit analysis involves expressing all relevant costs and benefits of a regulatory proposal in monetary terms in order to compare them on a common temporal footing. This technique is most usefully applied to proposals where the major benefits can be readily quantified.

Two main decision criteria can be applied in cost benefit analysis:

- **Net present value (NPV)** – The NPV of an option is the estimated value in present terms (today's dollars) of the flow of benefits over time less costs. Calculating the NPV involves estimating the annual costs and benefits of an option over a fixed period, and then discounting that stream of net benefits to its present value. A positive NPV indicates that an option results in a net benefit. The higher the NPV, the greater the net benefit.
- **Benefit cost ratio** – The benefit cost ratio for a particular option is derived from dividing the present value of total estimated benefits by the present value of total estimated costs. A benefit cost ratio of greater than one indicates a net benefit.

The key strength of cost benefit analysis is it allows a range of options to be compared on a consistent basis. However, the focus on valuing impacts can sometimes lead to the omission of impacts which cannot be valued quantitatively. Cost benefit analysis can also require considerable data. Where the impacts of a proposal are not significant, the cost and effort required for this type of analysis may not be warranted.

Cost Effectiveness Analysis

Cost effectiveness analysis is a useful approach where benefits of an option cannot be quantified readily in dollar terms but where the desired outcome can be clearly specified. In cost effectiveness analysis, the level of benefit desired is pre-specified and held constant for all options. Options are then assessed to identify the least cost means of achieving that objective.

For example, where an environmental outcome can be quantified in terms of environmental quality (such as the volume of environmental flows needed to ensure a healthy river) but not in dollar terms, cost effectiveness analysis can be used to determine the least costly way of achieving the outcome.

A technique for comparing alternative options which have varying outcomes is known as 'levelised cost'. This allows options to be ranked according to cost per unit of outcome. For example, to compare options to improve the efficiency of water supply in a particular system, the costs of each option could be compared on the basis of cost per litre of water saved.

Multi-Criteria Analysis

If it is not feasible to assign monetary values to costs or benefits of an option, qualitative analysis should be used to compare options or elements of those options. Multi-criteria analysis (MCA), or the balanced scorecard approach as it is sometimes called, is one technique for doing this. MCA requires judgments about how proposals will contribute to a set of criteria that are chosen to judge the benefits and costs associated with the proposals.

A number of different evaluation criteria are defined. A score is then assigned for each criterion depending on the impact of the policy option being considered. In its simplest form:

- a score of ‘-1’ could be assigned if the impact is negative/undesirable/poor
- a score of ‘0’ could be assigned if there is no impact or if the impact is neutral, and
- a score of ‘+1’ could be assigned if there is a positive/desirable/good impact.

More complex scoring schemes with a greater number of point scales can also be devised. Weightings should also be assigned to each of the criterion, reflecting their relative importance in the decision making process, and an overall score can be derived by multiplying the score assigned to each criterion by its weighting and summing the result.

Economic valuation techniques

In many cases, there is no market price for costs and benefits associated with a regulatory proposal. Economists have developed a range of approaches to estimate the economic value of non-market or intangible impacts. These techniques include:

- **Contingent valuation method** is a ‘stated preference’ method of valuing intangible impacts. It involves asking people to state directly their willingness to pay (or to accept compensation) for a particular outcome.
- **Contingent choice method** is similar to the above method, but is based on asking people to make trade-offs among sets of outcomes with associated costs.
- **Hedonic pricing** estimates costs or benefits of a characteristic with no market price, on the basis of how the market price of another good that has the characteristic is affected. For example, variations in prices of similar houses in different neighbourhoods may reflect the value of local environmental attributes.
- **Travel cost method** assumes the value of a recreational site is reflected in how much people are willing to pay to travel to visit the site.
- **Damage cost avoided, replacement cost and substitute cost methods** estimate the values of ecosystem services based on either the costs of avoiding damages due to lost services, the cost of replacing environmental assets, or the cost of providing substitute services. An example is the value of clean water measured by the cost of cleaning the water up, or by stopping it from becoming polluted in the first place.
- **Productivity method** estimates values for ecosystems or environmental systems that contribute to the production of commercially marketed goods (eg the value of certain insects by measuring their impacts on crop productivity through better pollination).
- **Benefit transfer method** estimates values by transferring existing benefit estimates from studies already completed for another location or issue.

In considering significant regulatory proposals, agencies may wish to seek expert advice to assist in selecting and developing the most appropriate framework for a robust evaluation of costs and benefits, including the estimation of the value of any intangible or non-market impacts.

The NSW Government Guidelines for Economic Appraisal⁷ provide further details on techniques for estimating non-market and intangible impacts.

Other issues to consider in evaluating costs and benefits

Transfers and double counting

When assessing aggregate costs and benefits, it is important to identify those which are purely transfers or redistributions from one group in the community to another, and those which represent an absolute increase or decrease for society as a whole.

An example of a transfer is the imposition of a pollution tax. The tax amount would show as both a cost to polluting businesses and a benefit to governments. While the costs and benefits to the different parties should be identified in the assessment, care should be taken they are not both included in the overall net impact. The double counting of costs and benefits can occur if the redistributive impacts of particular measures are not recognised.

Distributional impacts

Cost benefit analysis shows the net social benefit of different proposals, regardless of whom the costs and benefits accrue to. If the net social benefit is positive, those who stand to gain from the option could, in theory, compensate the losers and at least one person would be better off. As this does not occur in practice, some options may not produce a fair distribution of costs and benefits. Benefits of an option may accrue to one group, while another bears most of the cost.

Where there are distributional impacts, it is important to include an assessment of the impacts of proposals on different groups as part the assessment of costs and benefits. For example, this could include examination of the relative costs of complying with regulation for disadvantaged groups within the community.

Cumulative regulatory burden

Regulated parties can be affected by the burden imposed by multiple layers of regulatory requirements. Accordingly, it is important the cumulative impacts on business and other relevant groups in society are considered when developing proposals.

Risk and uncertainty

Cost benefit assessment should include an examination of the risk and uncertainty associated with policy options. In cases where the degree of uncertainty associated with a proposal is high, agencies should consider an early review of the proposal to ensure it is on track to achieve its policy objectives.

Sensitivity analysis

Sensitivity analysis can be used to show how changes in particular assumptions affect the outcomes of the impact assessment. Sensitivity analysis involves estimating outcomes using the plausible range of values for the uncertain inputs. The sensitivity analysis can demonstrate how the outcomes vary with changes in input assumptions. If outcomes are very sensitive to a change in a particular input, greater certainty about that input should be sought where possible to improve the assessment of costs and benefits.

⁷NSW Treasury 2007, 'NSW Government Guidelines for Economic Appraisal', Policy & Guidelines Paper TPP07-5 (July), <http://www.treasury.nsw.gov.au/tpdpdex>

Worked examples of quantification

The following examples are provided to illustrate simple methods of calculating impacts. For many regulatory proposals, particularly non-significant proposals, this type of information will be sufficient to meet the better regulation requirements.

Table 2: Examples of quantification

Legal profession admission reforms

The establishment of uniform principles for assessing overseas qualifications will reduce costs for a person applying for admission to the Australian legal profession. In particular, the reforms will remove the need for applicants who obtained a law degree or diploma in law in Australia to undergo an International English Language Test System (IELTS) test.

Assumptions:

- The Legal Profession Admission Board estimates the reforms will remove the need for around 300 applicants per year to produce IELTS results.
- The cost of an IELTS test is \$310 per person.

Cost savings per year:

(Number of applicants x saving per application) = $300 \times \$310 = \mathbf{\$93,000 \text{ per year}}$

Seafood store audit reforms

The reform of food safety requirements for premises that only store seafood will reduce costs for businesses by removing the need for an annual audit by the NSW Food Authority and weekly record keeping. This is expected to reduce costs for business and Government without reducing food safety standards for the community.

Considerations and assumptions:

- Each business will save around 52 hours per year (1 hour per week) by not having to complete food safety program records, and 1 hour per year in auditing time.
- There are 145 licensed seafood stores in NSW.
- It is assumed that seafood store workers are paid at the economy wide default rate of \$47 per hour.
- The annual audit fee is \$143.05 plus \$35.77 travel costs.
- These businesses will continue to be subject to regular inspection.

Cost savings to business per year:

Calculate the reduction in costs from removal of weekly record keeping:

(Number of businesses x time saved x hourly rate) = $145 \times 52 \times \$47 = \$ 354,380$ per year

Calculate the reduction in costs from removal of audit requirement:

(Number of businesses x fee) = $145 \times \$178.82 = \$ 25,929$ per year

Saving: $\$354,380 + \$25,929 = \mathbf{\$380,309 \text{ per year}}$

The savings to Government from fewer audits has not been costed.

Major changes to liquor licensing regulation commenced on 1 July 2008. The reforms included moving away from a court-based to an administrative-based licensing system, a new licence fee system and changes to the social impact assessment process for some types of licence.

Key regulatory impacts which can be quantified include:

- The availability of a new 'general bar' licence with a lower licence application fee. This facilitates entry into the liquor market by certain licensed venues that would have previously needed to apply for a more costly 'Restaurant/nightclub – permit for sale of liquor without meal' licence.
- A lower cost community impact statement (CIS) replaces the social impact assessment (SIA) process that must be followed by applicants.
- A reduction in the period allowed for submissions on an application for a general bar licence reduces the borrowing (holding) costs for businesses.

Considerations and assumptions:

- The application fee for a 'Restaurant/nightclub – permit for sale of liquor without meal' licence is \$10,000 – fees range from \$5,000 to \$15,000 depending on the size and location of the premises, and a midpoint of \$10,000 is chosen as a reasonable estimate.
- The application fee for a general bar licence is \$500.
- The typical consultancy fees to undertake an SIA are assumed to be three times the application fee, or \$30,000⁸.
- The relatively low risk surrounding establishments applying for a general bar licence is assumed to reduce the typical consultancy fees for a CIS to \$10,000.
- The application process under the new licence is reduced by 3 weeks.
- The typical value of capital held by a business applying for a licence is \$150,000 and this is fully financed through debt at a cost 9% per year.

Cost savings per year:

Calculate the costs (excluding capital costs) of applying for a licence under the old system:

(Application fee) + (cost of preparing SIA) = \$10,000 + \$30,000 = \$40,000

Then calculate what it costs to apply for a general bar licence (excluding capital costs):

(Application fee) + (cost of preparing CIS) = \$500 + \$10,000 = \$10,500

Reduced cost of applying for a licence = \$40,000 - \$10,500 = \$29,500

Estimate the reduction in capital costs:

(\$150,000 × 9% × 15 days) = \$555

Saving: \$29,500 + \$555 = **\$30,055 per business**

Assuming that 4 new bars are established in NSW each year, these reforms provide an estimated saving to business of \$30,055 × 4 = **\$120,220 per year.**

The largest impact of these reforms is the reduction of the opportunity cost associated with these types of businesses potentially being restricted from the market due to the high regulatory costs and other barriers to entry. This cost has not been quantified.

⁸An article by Tracy Ong ('Binge drinking Sydney eschews mini-bars' Australian Financial Review, Monday 7 July 2008) indicates that typical consultancy fees to develop an SIA may be three times the cost of the application fee.

E-learning modules have been introduced by the Office of State Revenue to make it easier for existing and potential clients to understand and comply with State taxes, duties and benefits.

Payroll tax modules: Three new e-learning modules educate clients about matters including grouping, contractors and employment. These modules reduce tax errors by clients and the number of telephone and written enquiries from existing and potential clients, benefiting business and Government.

Considerations and assumptions:

- In 2008-09, 3000 clients accessed the payroll modules.
- It is assumed that each access saves the client around 1 hour of time in training, rework and contact with the Office of State Revenue.
- The cost for a client is \$39 per hour⁹

Cost savings to businesses for the first year:

(Number of accesses x time saved x wage rate) = 3000 x 1 hour x \$39 = \$117,000

The savings to Government from fewer errors, and the cost savings to business and Government from fewer enquiries has not been costed.

Electronic duties returns (EDR) modules: Seven new e-learning modules assist clients such as solicitors and conveyancers to gain skills and correctly use the EDR system. These modules reduce phone enquiries, benefiting business and Government.

Considerations and assumptions:

- OSR makes around 800 client visits per year to provide training.
- It is assumed that each client visit saves around 1 hour of time in training by OSR.
- Client training costs \$35.91 per hour. Travel costs and incidentals have not been included.

Cost savings to OSR per year:

(Number of training visits avoided x training time saved x cost per hour) = 800 x 1 hour x \$35.91 = \$28,728

The savings to OSR from fewer client enquiries has not been costed.

First Home Owner Grant module: A new module released in 2008-09 assists personnel from Financial Institutions and Mortgage Brokers to lodge Grant applications correctly, removes the need for clients to attend a training course and reduces the number of telephone enquiries.

Considerations and assumptions:

- Around 50 new clients attend one of 7 training courses held by OSR each year.
- It is assumed that by not attending a training course, each client saves around 4 hours (including travel), and the cost of a client's time is \$47 per hour¹⁰
- Each training course costs OSR around \$900.

Cost savings to businesses per year:

(Number of training courses avoided x time saved x cost per hour) = 50 x 4 hours x \$47 = \$9,400 per year

Cost savings to OSR per year:

(Number of training courses avoided x cost) = 7 x \$900 = \$6,300 per year

The savings to OSR from fewer client enquiries has not been costed.

Total savings to business in the first year = \$117,000 + \$9,400 = **\$126,400**

Total savings to Government in the first year = \$28,728 + \$6,300 = **\$35,028**

The typical cost of developing an e-learning module is estimated to be \$10,000 comprised mainly of staff costs.

⁹*Measuring the Costs of Regulation, Better Regulation Office, 2008. \$39 per hour is the default hourly wage for clerical and administrative workers (page 5).*

¹⁰*Measuring the Costs of Regulation, Better Regulation Office, 2008. \$47 per hour is the economy wide default hourly wage (page 5).*

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