

# The 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 should be followed in the development of every regulatory proposal.

- 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

This section of the Guide sets out the processes and practices to consider and apply to meet the requirements of the better regulation principles.

All new regulatory proposals will need to demonstrate to decision makers that the better regulation principles have been adopted and that regulatory proposals are required, reasonable and responsive. For significant proposals (defined in Section 2), a Better Regulation Statement will be required. Guidance on how to demonstrate a proposal is in line with the principles, including how to prepare a Better Regulation Statement, is provided in Section 2.

## **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 environment 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.

It is also important to identify whether the objectives can be achieved by amending existing regulation rather than imposing another layer of regulatory requirements.

## **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.

## **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 information campaigns, persuasion, self-regulation or quasi-regulation
- co-regulation
- creating markets or developing market based instruments
- performance based versus prescriptive regulation
- the application of charges or subsidies, or
- creating financial liability for the detrimental effects of activity.

These options, together with case studies, 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.

### 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. The NSW Government has developed an *'Innovation Statement'*<sup>2</sup> to encourage innovation.

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.

When developing options keep in mind:

- the significance of the problem to be addressed
- the need for flexibility or certainty
- the type and structure of the industry involved, including existing institutional structures
- the availability of resources and the potential burdens associated with implementation and compliance
- the interaction of options with existing regulatory schemes
- whether existing regulation can be applied or modified
- whether regulatory schemes from other jurisdictions can be used as a precedent, and
- whether national or cross border harmonisation should be pursued.

As part of its commitments under the Council of Australian Governments' National Reform Agenda, the NSW Government has committed to efforts to pursue cross border harmonisation where possible. The impetus behind the push for harmonisation of regulation is the recognition that businesses that operate across several States and Territories can face significant costs when forced to deal with different regulatory regimes in different jurisdictions.

<sup>2</sup>NSW Government Innovation Statement, <http://www.business.nsw.gov.au/innovation>

## Assess the impact of options

The elements of good impact assessment processes are discussed below. One of the key focus areas of this Guide is the need to understand compliance costs and impacts on competition.

### 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. Further details about consultation are provided in Section 3 of this Guide.

### Identify costs and benefits

Costs and benefits of each proposed option can include compliance costs, economic impacts, social impacts and environmental impacts.

- **Compliance costs** are the direct cash flow effects of a regulatory requirement. They can include administration time and costs, compliance and enforcement costs and monetary savings expected from the option.
- **Economic impacts** affect the allocation of resources, productivity, competition and innovation. Other economic impacts include opportunity costs (ie 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.

Both direct and indirect impacts of options should 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.

The table below gives examples of the types of costs and benefits associated with regulatory options for different groups within society.

**Table 1: Examples of Costs and Benefits of Regulation for Different Groups**

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

Thoroughly understanding **compliance costs** is a key element of applying the better regulation principles. Administrative requirements can restrict competition and reduce economic efficiency and consumer welfare and so should be minimised. Compliance costs can include:

- developing and maintaining reporting systems
- the costs of obtaining professional advice (eg lawyers or accountants)
- administration costs such as notifications and permissions
- the need to educate or train staff about new regulatory requirements and procedures
- purchasing equipment or changing production processes to comply with regulatory requirements
- the cost of inspections to verify compliance, and
- reporting costs.

The information required to estimate business compliance costs can come from consultation with businesses and industry associations or peak bodies as well as from surveys or data from the Australian Bureau of Statistics.

Particular attention should be paid to the impacts of proposed options on small business, which makes up approximately 95% of all enterprises in NSW<sup>3</sup>. 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.

There is a range of methods and tools which can be used to calculate business compliance costs, depending on the nature of the regulatory proposal. For example, the Commonwealth Office of Best Practice Regulation has developed the Business Cost Calculator, an IT based tool to estimate and compare the business compliance costs of various policy options<sup>4</sup>. The Victorian Competition and Efficiency Commission has developed its own model for measuring administrative (paperwork) costs of regulation<sup>5</sup>.

Agencies are encouraged to assess the costs of complying with new regulatory proposals by the methodology most appropriate to their circumstances, and in proportion to the significance of the issue. The Better Regulation Office can provide more detailed guidance for agencies on estimating and reporting compliance costs of regulatory proposals.

### 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.

Where possible, quantitative or dollar values for costs and benefits should be determined. This allows for clearer comparison both across and between options, and supports independent validation of the results. The two main methods available to assess and compare quantitative costs and benefits of options are **cost benefit analysis** and **cost effectiveness analysis**.

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

<sup>4</sup> Office of Best Practice Regulation, <http://www.obpr.gov.au/businesscostcalculator.html>

<sup>5</sup> Victorian Competition and Efficiency Commission 2006, *Interim Victorian Standard Cost Model Manual*, <http://www.vcec.vic.gov.au>

When impacts are intangible, or cannot be easily quantified (such as with social or environmental impacts), it may be possible to assign notional or proxy market values using economic valuation techniques. The NSW Government Guidelines for Economic Appraisal<sup>6</sup> provide further details on such techniques. However, the need for this should again be considered in light of the significance of the problem being addressed.

Where it is not practical to assign even notional values to the impacts of a regulatory option, they should be dealt with in a descriptive or qualitative way. Techniques have been developed, such as **multi-criteria analysis**, which allow the results to be ranked in a similar way to quantitative frameworks.

Appendix C provides more detailed information on the use of quantitative and qualitative methods, some of the key factors to consider in developing quantitative analysis, and an overview of some valuation techniques for intangible impacts.

### Identify competition restrictions

Regulatory proposals should be assessed against the competition test described in the *Competition Principles Agreement 1995*<sup>7</sup>. 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.

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.

### Identify the recommended option

Once the regulatory impact assessment is completed, options should be compared in terms of net social benefit.

This 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 should also be provided. The main assumptions used in the analysis should be stated.

<sup>6</sup> NSW Treasury 2007, 'NSW Government Guidelines for Economic Appraisal', Policy & Guidelines Paper TPP07-5 (July), <http://www.treasury.nsw.gov.au/tppdex>

<sup>7</sup> The 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, <http://www.ncc.gov.au/>

## 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. A strategy that targets compliance helps 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.

## 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 in terms of time frame and stakeholders
- appropriate level of detail needed to understand the impacts, including the measurement of compliance costs
- need to include compliance and reporting procedures.

## 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 has been extended to 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. This can be found in Section 3.

## 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 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 at this point. As noted previously, greater uniformity in regulation across jurisdictions helps cut compliance costs for businesses operating across state borders. While the NSW Government is engaging in efforts to harmonise with other states and territories in a number of existing regulatory areas, harmonisation should also be pursued during the initial development stage of regulation.

### **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 new review clause will be required in all Bills. Statutory rules will continue to be reviewed under the provisions of the *Subordinate Legislation Act 1989* 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 will be added to any new or amending legislation.