

Appendix B:

Non-Regulatory and 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 If a new approach is needed, the existing regulation may need to be repealed or consolidated.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:

- information campaigns
- persuasion
- self-regulation, or
- quasi-regulation.

Information campaigns

Information and education campaigns

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 (buying dangerous cars for example, or eating an unhealthy diet or investing in businesses that are hopelessly in debt). An information based strategy that educates rather than coerces can be the best way to remedy these kinds of problems.

Information can be a very powerful tool. The US Environmental Protection Agency considered remedial action for asbestos in school buildings but decided instead simply to require that the students' parents be notified if asbestos is present. The result was a far more aggressive program of asbestos removal than the agency had been contemplating. Indeed, the Agency had to caution parents and schools against over reacting to the presence of asbestos.

One type of information based strategy is publication by the Government. For example, the US Department of Transportation publishes the on time 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. In other cases it may decide to use the data as part of a program of persuasion discussed below.

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 is far easier to get that information into the hands of consumers than to try to collect all of the information that would be required for the Government to substitute its own judgment about when and how goods and services should be used.

For example, it is better to label appliances with energy use information than to set energy efficiency standards, since the Government does not know whether a furnace will be installed in a well or poorly insulated house, whether an airconditioner will be used daily, or only on weekends, how many people will be taking showers from a water heater, or how many children will be contributing laundry to a washing machine. All these conditions change the cost effectiveness of specific energy use decisions.

Industries will sometimes welcome and cooperate in the development of standards for accurate labelling, advertising etc. Deceptive information practices rarely help, and often hurt an industry and particularly its more responsible firms, although individual sellers may have incentives to deceive consumers. Therefore, information based strategies are worth considering as self regulation options.

If an information based strategy does not appear to be working, it should not immediately be replaced with mandatory standards. It may be time to rethink the underlying premises of the program. Perhaps consumers are not so poorly informed but simply disagree with the Government about what is in their best interest. If consumers have all the information they need, and price signals are accurate, then an information based strategy should not be abandoned as ineffective because it does not meet a target predetermined by the regulators for how consumers should behave. Sometimes a bit of deference to consumer sovereignty may be in order.

Mandatory information campaigns

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 are likely to be much less costly than alternatives that set mandatory standards.

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.

Persuasion

Persuasion is a tool governments can use to encourage positive behaviour without enforcing rules directly. It is a variation on information based strategies in which governments seek to leverage values of good citizenship, good corporate behaviour, self preservation or peer pressure to achieve public ends.

Persuasion may be necessary when public consensus about the need for more authoritarian action is insufficient, or when regulation has simply reached its limits in changing behaviour. It can also be used in conjunction with other regulatory based approaches. For example, many countries have effective persuasion programs to prevent drunk driving, to reduce smoking, to conserve energy, to avoid discrimination and to reduce litter.

Persuasion can be particularly effective when governments seek to influence the behaviour of businesses. Many businesses seek to enhance their reputation by demonstrating that they are good corporate citizens.

However, this approach has an inherent ‘free rider’ problem. The burden of resolving the policy problem rests on those who are morally sensitive or those with lower compliance costs. These may only constitute a small minority of the people or businesses whose behaviour government is trying to influence. Sometimes, this option may be most effective when used in conjunction with other instruments.

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 government 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 their compliance, 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 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.

On the other hand, it may be more difficult to achieve the desired policy outcomes as it can be difficult to estimate the precise quantum of the charge required to achieve the appropriate behavioural response.

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 will need to be dealt with by using 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 and Climate Change 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 will encourage innovation. This approach is particularly important in situations where rapid change is being experienced, for example, with fast paced technological advances. Prescriptive approaches can quickly become out of date in these circumstances whereas performance based approaches allow business to continue to innovate, for example, by adopting new technology, and continue to meet regulatory requirements.

Performance based regulatory schemes can also be cheaper to implement and administer than prescriptive regulation. However, in some cases reducing the costs of compliance for industry may result in higher administration or enforcement costs to government. This is because the range of available compliance strategies may make verification of compliance 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. Smaller businesses in particular, may not welcome performance based regulations that impose a greater responsibility to develop appropriate compliance strategies as this may create uncertainty and it may be easier for smaller business to simply meet defined requirements. In these cases, consideration should be given to deemed compliance provisions that smaller businesses can rely on if they choose.

Other Jurisdictions' Responses to Similar Problems

Where relevant, consideration should be given to ways in which other states and territories, the Commonwealth and other nations' governments have responded to similar policy problems or achieved the relevant policy objective. Regulatory harmonisation across jurisdictions can minimise duplication of effort, save money and enhance consistency across jurisdictions where possible.

However, if another feasible option results in a greater net social benefit and lower compliance costs, harmonisation with an existing approach in another jurisdiction may not be desirable. Similarly, care should be taken to avoid the 'lowest common denominator' effect where the achievement of policy objectives is undermined because another jurisdiction has more lenient requirements.

The objective is to harmonise regulatory approaches where it will facilitate competitiveness, reduce costs and improve efficiency, without compromising the achievement of policy objectives.

Example of harmonisation – WorkCover National Certificates of Competency

WorkCover NSW is participating in a harmonisation initiative with other jurisdictions to reduce regulatory complexity and duplication. As part of this initiative, jurisdictions are working together to implement the operation of a nationally uniform and efficient system for licensing people doing high risk work.

Under the scheme, all jurisdictions will issue National Certificates of Competency (NCOC) licences for people operating complex or high risk machinery (eg cranes, earthmoving equipment, forklifts etc). All jurisdictions accept the same set of competencies and recognise a NCOC issued by another jurisdiction.

This exercise will avoid administrative costs of developing and maintaining separate competency testing and licensing regimes and costs to workers and employers of being licensed in more than one jurisdiction. Efficiency savings should also result from freeing up the movement of labour between jurisdictions.