



## Regulatory Standards Act implementation: Updated draft of section 26 guidance

<b>Date</b>	29 January 2026	<b>Priority</b>	High
<b>Security classification</b>	In confidence	<b>Tracking number</b>	MFR2026-014
<b>Attachments</b>	Annex 1: Updated draft guidance Annex 2: Draft economic underpinnings resource		

### Action sought

Required from	Action	Deadline
Hon David Seymour Minister for Regulation	Agree to the recommendations in this briefing	4 February 2026

### Contact for discussion if required

Name	Position	Phone number	1 <sup>st</sup> contact
Elisa Eckford	Lead Advisor, Policy	s 9(2)(a)	<input checked="" type="checkbox"/>
Pip van der Scheer	Manager, Regulatory Management System	s 9(2)(a)	<input type="checkbox"/>

#### Minister's office to complete

- |   |  |
|---|--|
| <input type="checkbox"/> Approved             | <input type="checkbox"/> Declined            |
| <input type="checkbox"/> Noted                | <input type="checkbox"/> Needs change        |
| <input type="checkbox"/> Seen                 | <input type="checkbox"/> Overtaken by events |
| <input type="checkbox"/> See Minister's notes | <input type="checkbox"/> Withdrawn           |

#### Comments

Annex 1 is withheld consistent with section 9(2)(h) of the Official Information Act 1982 to maintain legal professional privilege. The final Guidance issued under section 26 of the Regulatory Standards Act 2025 is available at: <https://www.regulation.govt.nz/about-us/our-publications/guidance-issued-under-section-26-of-the-regulatory-standards-act-2025/>



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### Purpose

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This briefing provides you with:

- an updated draft of the guidance to be issued jointly by you and the Attorney-General under section 26 of the Regulatory Standards Act, for your review (attached as **Annex 1**)
- a draft of a economic underpinnings resource referred to in the guidance, to support agencies to apply economic frameworks to their consistency assessments and their broader analysis of regulatory proposals (attached as **Annex 2**).

It also provides suggested next steps to finalise and issue the guidance.

### Executive summary

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We provided you with a first draft of the guidance in November last year for your feedback (MFR2025-320 refers). We understand that, while you were broadly comfortable with that draft, you wanted to see:

- more clarity for agencies on what would constitute consistency or inconsistency with the principles
- greater reference to economic frameworks to support agencies to apply these during policy and legislative development.

The draft guidance attached as Annex 1 to this paper incorporates changes that address your feedback, as well as reflecting ongoing discussions with the Parliamentary Counsel Office (PCO) and the Crown Law Office (CLO) on the application of the principles.

In our view, these changes:

- mean that the guidance will be far more helpful in supporting agencies to assess consistency and identify inconsistency when completing Consistency Accountability Statements (CASs)
- will better support agencies to apply economic frameworks during the policy and legislative development stage by linking to resources on economic underpinnings developed by the Ministry (attached as Annex 2 to this paper).

We have also made minor changes after:

- testing the usability of the guidance in the completion of a worked example (MFR2026-06 refers)
- reviewing the guidance for consistency with new impact analysis and legislative review processes proposed in the Cabinet paper *Strengthening and streamlining processes for making and reviewing regulation* (MFR2026-01 refers).



Once we have received and incorporated your feedback on the guidance, we will aim to produce a final draft for your and the Attorney-General's in-principle approval by Thursday 12 February (dependent on the nature of the feedback), before the guidance is circulated to Ministers more broadly as part of ministerial consultation.

This final draft will also reflect further feedback from PCO and CLO, as we continue to work with them to reflect their views on how the principles apply in the context of their legal meaning.

This timing would result in the guidance being considered by Cabinet in early March. We will continue to liaise with your office on the timing and sequencing of the various Cabinet decisions needed for implementation of the Act.

We have also considered how best to re-engage with the Regulations Review Committee (RRC) on the guidance following your letter to them of 15 October. We propose to share the draft guidance with the RRC at the same time as it is circulated for consultation with ministers, noting that this would need both your and the Attorney-General's agreement.

## Recommended action

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The Ministry for Regulation recommends that you:

- |   |  |                         |
|---|--|-------------------------|
| a | <b>agree</b> to provide feedback on the latest draft of the guidance (Annex 1) and the supporting economic underpinnings resource (Annex 2) by Tuesday, 4 February                             | <i>Agree / Disagree</i> |
| b | <b>note</b> that that we propose to provide a final draft for your and the Attorney-General's review by Thursday 12 February, dependent on the nature of further feedback from you and CLO/PCO | <i>Noted</i>            |
| c | <b>agree</b> to share the final draft guidance with the Regulations Review Committee, subject to the Attorney-General's agreement, after it is sent out for consultation with ministers        | <i>Agree / Disagree</i> |
| d | <b>agree</b> that this briefing be released at an appropriate time, with some information withheld in accordance with the provisions of the Official Information Act 1982.                     | <i>Agree / Disagree</i> |

s 9(2)(a)

Pip van der Scheer  
**Manager, Regulatory Manager System**  
Ministry for Regulation  
Date: 29 January 2026

Hon David Seymour  
**Minister for Regulation**  
Date:



## Background

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1. We provided you with a first draft of the guidance in November last year for your feedback (MFR2025-320 refers). We understand that, while you were broadly comfortable with that draft, you wanted to see:
  - more clarity for agencies on what would constitute consistency or inconsistency with the principles
  - greater reference to economic frameworks to support agencies to apply these during policy and legislative development.
2. We have been working closely with the Parliamentary Counsel Office (PCO) and the Crown Law Office (CLO) to address your feedback in this latest draft, while recognising the constraints imposed by the statutory status of the guidance (in particular, that the guidance will need to reflect the legal meaning of the principles).
3. The guidance currently comprises three parts:
  - Part 1: Applying the principles of responsible regulation
  - Part 2: Producing a CAS
  - Part 3: Regularly reviewing existing legislation

## Main changes from previous version of the guidance

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4. Changes made to the previous versions of the guidance and reflected in the current version fall mainly into three main areas:
  - changes that provide more clarity on what constitutes inconsistency with the principles
  - greater reference to economic frameworks
  - broader references to other principles, standards or guidelines beyond the Act.
5. We have also made minor changes after:
  - testing the usability of the guidance in the completion of a worked example (MFR2026-06 refers)
  - reviewing Parts 2 and 3 of the guidance for consistency with new impact analysis and legislative review processes proposed in the Cabinet paper *Strengthening and streamlining processes for making and reviewing regulation* (MFR2026-01 refers).
6. We are still working closely with PCO and CLO to reflect their views on how the principles apply in the context of their legal meaning, and PCO and CLO are yet to review the examples of consistency and inconsistency.

### *More clarity on what constitutes inconsistency with the principles*

7. As noted in the introduction, the guidance is not able to provide an exhaustive list of all considerations that might be relevant when completing a CAS, or to define precisely what inconsistency with the principles might look like in all situations. This is because the application of each of the principles will often involve fine judgements that will depend



significantly on the context – for instance, the degree to which someone’s rights will be impacted, and/or the relative importance of those rights.

8. However, further work has been done in Part 1 of the guidance to more clearly set out expectations for identifying inconsistency – with key indicators of inconsistency set out under each principle in bullet point form, and a summary of these indicators provided in an annex to the guidance.
9. In addition:
  - a more detailed context section has been added for each principle, setting out the broad intent of the principle in the light of the objectives of the Act, and key considerations when applying it
  - the boundaries between when a principle applies to legislation, when legislation is likely inconsistent with a principle, and what should be considered as a potential reason for inconsistency with a principle have been reviewed and refined to avoid creation of ‘false positives’ – particularly in the rule of law section, where impact on the rule of law more broadly is considered as part of determining inconsistency with the particular sub-principles
  - an example of consistent and inconsistent legislation has been provided under each principle – noting that these examples have not yet been reviewed by PCO and CLO. We will also do further work to provide examples of ‘edge’ cases where possible, (rather than obvious examples of consistency and inconsistency as some of the examples are now), to ensure they are as helpful as possible for agencies
  - the structure of the guidance under each principle has been standardised to help make it more straightforward for agencies when completing the template.

#### *Greater reference to economic frameworks*

10. [LEGALLY PRIVILEGED s 9(2)(h) [REDACTED]  
[REDACTED]. There is therefore limited ability for application of economic frameworks to be explicitly required by the guidance – except insofar as these frameworks are integrated into New Zealand law.
11. However, we think the guidance can nevertheless help support agencies to apply economic frameworks during the policy and legislative development stage by linking to resources developed by the Ministry, particularly in relation to the good law-making principles.
12. The good lawmaking principles essentially require agencies to assess the robustness of the processes they have followed in developing legislation, including problem definition, options identification, and cost-benefit analysis processes. Economic resources provided by the Ministry can support agencies to follow best practice in relation to each of these processes, helping agencies to produce more robust Regulatory Analysis Summaries (RASs) and CASs.
13. An initial draft of these resources is attached as Annex 2, and there are specific links to the resources in the appropriate sections of the guidance. These resources would not be part of the formal guidance.



## Reference to other principles, standards or guidelines

14. As noted in the introduction to the guidance, requirements under the Act have no impact on agencies' obligations to consider other principles or follow other processes in the development and review of legislation, including both statutory and administrative requirements.
15. There is a degree of overlap between some of these requirements – in particular principles in the New Zealand Bill of Rights Act 1990 (BORA), and the principles set out in the *Legislation Guidelines*. The guidance therefore notes any such overlaps under each relevant principle, and where to go for further information.
16. [LEGALLY PRIVILEGED s 9(2)(h)]

## Next steps

17. Once we have received and incorporated your feedback on the guidance, along with further feedback from CLO and PCO, we will produce a final draft for your and the Attorney-General's in-principle approval, before the draft guidance is circulated to Ministers more broadly as part of ministerial consultation.
18. We understand that the Attorney-General will be given a process update on the guidance next week, but that the guidance will not be shared with her at this point.
19. Proposed next steps for the guidance are set out in the table below.

Next step	Date
Minister's feedback on guidance provided to Ministry	Tuesday 4 February
Final draft reflecting Minister's and further PCO/CLO feedback provided to Minister and Attorney-General for in-principle approval	Thursday 12 February (Subject to the nature of the feedback)
Draft guidance circulated to Ministers	Thursday 19 February
Guidance finalised	2 March
Guidance considered by Cabinet	Early March

20. We note that the current intention is to attach the guidance to the Cabinet paper *Strengthening and streamlining processes for making and reviewing regulation* (reflecting the recommendation in the paper to make the guidance compulsory for the agencies subject to Cabinet direction via the Cabinet circular - MFR 2026-01 refers). We will continue to liaise with your office on the timing and sequencing of the various Cabinet decisions needed for RSA implementation.



21. We have also considered how best to re-engage with the Regulations Review Committee (RRC) on the guidance. Your letter to them of 15 October noted that you had asked officials to consider how to best reflect the RRC's jurisprudence when developing the guidance. While we have engaged with RRC since then, we have not discussed the guidance directly with them. We therefore propose to share the draft guidance with the RRC at the same time as it is circulated for consultation with ministers, noting that this would need both your and the Attorney-General's agreement.

## **Proactive release**

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22. With your agreement, the Ministry will proactively release this paper at the appropriate time in accordance with Official Information Act 1982 and Privacy Act 2020 requirements to support transparency and public trust in decision-making processes.
23. The Ministry will not release draft guidelines while they are still in development.



## **Annex 1: Updated draft guidance**

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Annex 1 is withheld consistent with section 9(2)(h) of the Official Information Act 1982 to maintain legal professional privilege. The final Guidance issued under section 26 of the Regulatory Standards Act 2025 is available at: <https://www.regulation.govt.nz/about-us/our-publications/guidance-issued-under-section-26-of-the-regulatory-standards-act-2025/>

# Briefing

MFR2026-014



**Ministry for Regulation  
Te Manatū Waeture**

## **Annex 2: Draft economic underpinnings resource**

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# **RSA Economics underpinnings guidance – cost-benefit analysis**

Draft

27 January 2026

## **Introduction**

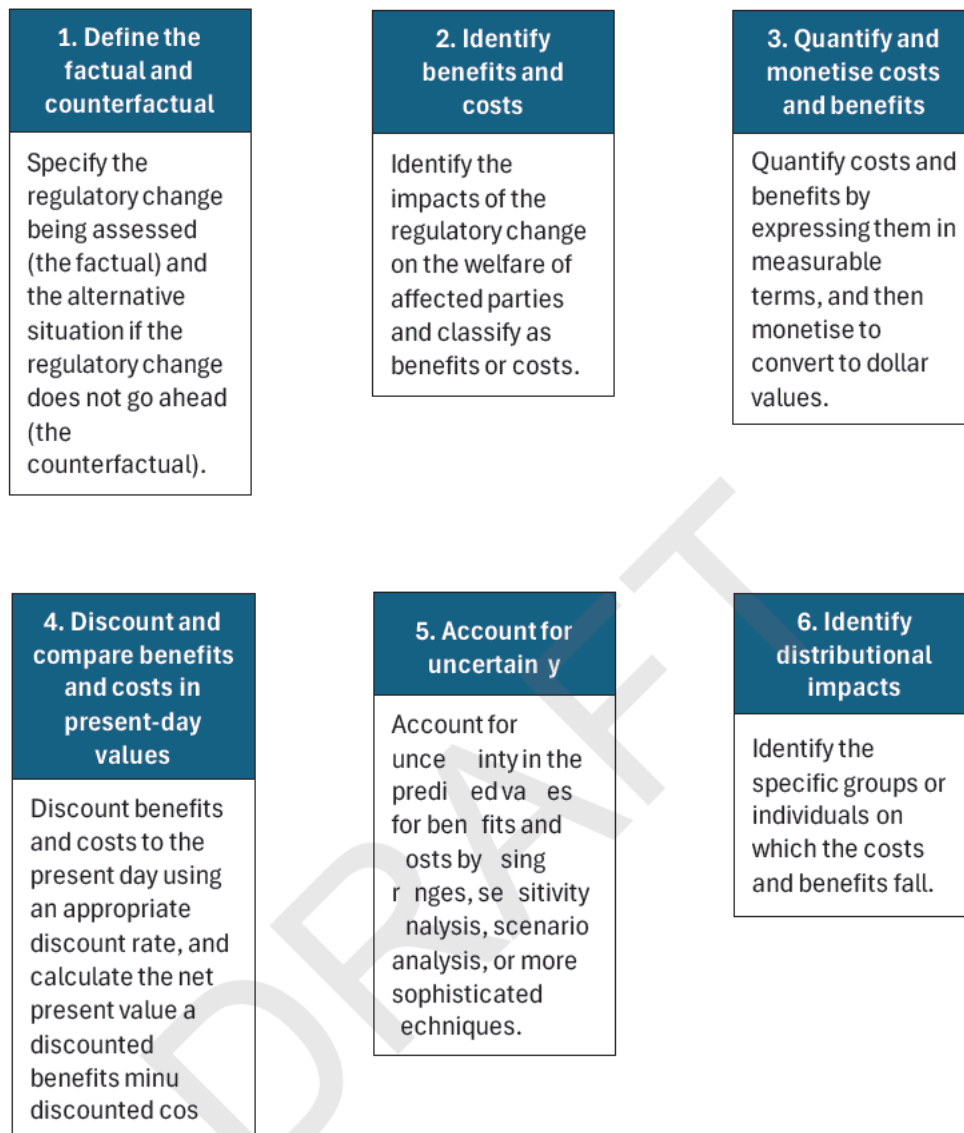
This document is intended to provide additional support to agencies to the Guidance issued under section 26 of the Regulatory Standards Act 2025. It will provide support in:

- Early policy development;
- When preparing a Consistency Accountability Statement; and
- When preparing a Regulatory Analysis Summary.

The specific focus of this document is on cost-benefit analysis (CBA). The related provisions of the Regulatory Standards Act are 9(j)(v): “who is likely to benefit, and who is likely to suffer a detriment, from the legislation” and 9(l): “legislation should be expected to produce benefits that exceed the costs of the legislation to the public or persons”.

CBA is an analytical technique that identifies the costs and benefits of a regulatory change, measures them in dollars where possible, and determines the net benefit (benefits minus costs). This document provides some preliminary background to what CBA is (and is not) and its appropriate use. It then explains in more detail the key steps to undertaking CBA, which are illustrated in Figure 1.

Figure 1: Step-by-step guide to conducting cost-benefit analysis



## What cost-benefit analysis is (and is not)

CBA is an analytical technique used to identify and measure (in dollars) the costs and benefits of a regulatory change, and calculate the net benefit (benefits minus costs).

The net benefit of a regulatory change is the increase it gives to the aggregate welfare of society; that is, how much it makes society better off. It consists of more than just direct financial impacts and impacts related to goods and services traded in markets; the net benefit incorporates *all* things that affect people's welfare. This includes impacts on the environment (e.g., air and water quality, noise levels, biodiversity), impacts on people's time (e.g., travel time or leisure time), and social impacts (e.g., crime or mortality risks). For example, a regulatory change that negatively impacts health and safety will include

these impacts as a cost. A regulatory change that reduces the time spent on compliance will include these time savings as a benefit.

CBA compares two different scenarios, such as the current regulatory scenario and a proposed alternative scenario. CBA is not used for an analysis of solely the current regulatory scenario, such as estimating compliance costs; it would only determine how these costs might differ by comparing regulatory scenarios. For example, analysing the costs and benefits of existing legislation under the Regulatory Standards Act would require some alternative scenario to measure those costs and benefits relative to.

CBA must account for both costs and benefits. For example, a CBA would not focus only on compliance costs, while ignoring benefits. Although expressing some impacts in dollar terms may be challenging, difficult-to-quantify impacts should not be ignored. Even if costs and benefits cannot be converted into dollar terms within the time available or due to data constraints, they should still be disclosed.

The value of CBA is not only in showing whether a regulatory change improves the lives of New Zealanders on average (which is a primary goal of regulation), but also in increasing rigour and objectivity by introducing analytical discipline and structure to decision-making. CBA makes clear the trade-offs and their underlying assumptions, and helps identify the assumptions that matter most, focusing the debate and facilitating independent testing of assumptions. By allowing impacts to be expressed in dollar terms, CBA provides a way of assessing and balancing these impacts using a common metric.

Importantly, CBA is not a substitute for other forms of analysis, such as stakeholder engagement, literature reviews, agency consultation, and expert judgement. The net benefit should not be seen as the sole determinant of whether a regulatory change is appropriate; rather, it is complementary to the broader suite of inputs and analysis that collectively support robust evidence-based decision-making.

### **The proportionate use of cost-benefit analysis**

CBA should be used by agencies to meet their requirements under the Regulatory Standards Act. However, the type of CBA conducted will depend on various factors. There are circumstances where a rough, high-level CBA is appropriate and other situations where a detailed, precise CBA is preferable. The following factors can help determine the proportionate CBA approach to apply to a regulatory change:

- **Scale:** the scale of the regulatory change (e.g., smaller scale changes that focus more on reducing duplication or improving processes versus more significant regulatory changes that induce structural or behavioural change and are likely to involve costs or benefits that are large in dollar terms);

- **Data availability:** the availability of data to put a dollar value on ('monetise') costs and benefits; and
- **Nature of costs and benefits:** whether the nature of the costs and benefits allows for relatively straightforward monetisation (e.g., environmental, social, cultural, and similar non-market impacts for which assigning dollar values can be more difficult, or compliance costs, administrative costs, or financial impacts for which there are often readily assignable dollar values).

At a minimum, CBA should identify and analyse benefits and costs in qualitative terms. At one extreme (e.g., when the scale of the change is small, data are limited, and monetisation is difficult), monetisation may not be appropriate, and it may be sufficient to list and describe costs and benefits in a table. At the other end of the spectrum, a more detailed CBA may be warranted, where most or all of the impacts are evaluated in dollar terms. Between these two extremes lies a range of intermediate approaches, for example, where dollar values are assigned only to those impacts that are easily monetised or for which public data exist.

Ideally, CBA should be undertaken relatively early in the policy process, although only after options for regulatory change have been identified and appropriately scoped. This allows CBA to be used to assess the different options and improves the chance the option that offers the greatest net benefit will be chosen. Leaving CBA to the end once a preferred option has been chosen robs it of some of its potential to improve decision-making. A proportionate approach can also be considered here; for example, a higher-level CBA for the different options, proceeding to a more detailed CBA once the preferred option has been selected.

## **Key steps of cost-benefit analysis**

The following key steps of CBA outline the general approach and articulate how to undertake a basic level of analysis. They are not a comprehensive guide to undertaking a CBA, which would necessarily be highly detailed, due to CBA often involving technical and bespoke considerations.<sup>1</sup>

**Step 1: define the factual and counterfactual:** the first step in any CBA is to identify two alternative 'states of the world', the factual and the counterfactual. The factual scenario is the situation if the regulatory change being assessed went ahead, and the counterfactual is the situation without the regulatory change. The status quo, or current situation, is sometimes the appropriate counterfactual. However, if the current situation is expected to evolve without regulatory change, the appropriate counterfactual will be

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<sup>1</sup> For more comprehensive guidance, see the Treasury's "Guide to Social Cost Benefit Analysis", July 2015, [Guide to Social Cost Benefit Analysis - July 2015](#) and its "CBAX Tool User Guidance", November 2025, [CBAX Tool User Guidance - Guide for departments and agencies using Treasury's CBAX tool for cost benefit analysis - November 2025](#).

this evolved situation. For example, legislation may be proposed to address a problem of consumers not having adequate information on a particular product (the factual). However, there may be good evidence that private sector businesses are developing their own solution to this problem. The appropriate counterfactual is therefore the private solution to the problem (rather than a counterfactual of the status quo, where the problem exists without a solution).

In any CBA, it is important to understand the factual and counterfactual, because the costs and benefits of the regulatory change in the factual are assessed *relative to* the counterfactual. That is, costs and benefits are only those that are additional to what would otherwise occur in the counterfactual.

**Step 2: identifying costs and benefits:** costs and benefits are defined in terms of concrete impacts on the welfare of affected parties, including impacts on resource use (additional resources required or avoided), environmental outcomes, time savings, health, crime, etc. Impacts can fall on a wide range of groups, including the general public, businesses, consumers, taxpayers, government agencies, and communities.

CBA is typically undertaken at a 'national' level where the costs and benefits counted are those that fall on New Zealanders. This would not include benefits and costs that accrue to parties outside New Zealand e.g. profits paid out to foreign shareholders, benefits to tourists, benefits to overseas consumers. It would also exclude benefits to one group of New Zealanders (e.g. within one region) that are directly matched by costs to another group of New Zealanders. These are considered transfers, discussed below; they have distributional impacts, but do not affect the net benefits of the regulatory change.

A useful approach to identifying the benefits of new regulation is to start from the market failure the regulation intends to address. For example, if a regulation intends to address market power, then the benefits might be increased welfare from an increase in quantities traded with improved competition. If the relevant market failure is an environmental externality, then the benefit might be improved environmental outcomes.

If the proposed regulatory change is different or less regulation, consider whether the change will mean the market failure is addressed more effectively (generating benefits), or less effectively (generating costs).

The costs of new regulation include compliance, administrative, and distortionary costs. Compliance costs are the costs affected parties face to comply with the regulation, and include not only direct financial costs but also the costs of time spent on compliance. Administrative costs are the costs of administering a regulatory regime, usually borne by the regulator. Distortionary costs are the indirect costs imposed by regulation through distorting behaviour and market outcomes. This includes when regulation: creates barriers to entry and expansion or more broadly undermines

competition; distorts price signals in markets; dampens incentives for innovation; or hinders the emergence of new markets.

When evaluating a change in regulation, consider whether the change will increase or decrease each of these types of cost relative to the counterfactual. Increased costs of regulation should be counted as costs and decreased costs as benefits.

In identifying benefits and costs, caution should be exercised in identifying transfer payments. A transfer payment is a payment between two parties that does not directly involve any change in resource use. The benefit to the recipient directly offsets the cost to the payer. The main types of transfer payment are taxes, subsidies, welfare payments, and local authority rates. These payments simply shift money between parties, with no direct change in the production or consumption of resources (such as labour, land, or capital). Transfer payments should not be included in the net benefit calculation as either costs or benefits. However, they should be considered when evaluating distributional effects, discussed later.

Every cost and benefit should be included only once, and care should be taken to avoid double counting. An example of double counting is where the money a government department receives (e.g., via a fee or levy) is included as a benefit, and what the money is spent on is included as another benefit. The benefit arises because of what the money is spent on, and it can be measured by the amount received, but it is double counting to include both. Another example is where both the upfront capital expenditure of an investment and annual depreciation are included as costs. Depreciation is an accounting charge that spreads the capital cost over the life of the investment, so should be excluded to avoid double counting.

**Step 3: quantify and monetise costs and benefits:** quantifying costs and benefits involves expressing them in measurable terms, such as hours of travel time saved, number of lives saved, or tonnes of carbon emissions avoided. Monetisation then converts these quantified impacts into dollar values, using appropriate values such as wage rates, willingness-to-pay measures, costs per unit, or the statistical value of a life. These values can be obtained from various sources. The Treasury's CBAX spreadsheet model includes values for a wide range of impacts, such as for health and safety, environmental attributes, and leisure activities.<sup>2</sup> Other sources are the economics literature or calculations by other agencies.<sup>3</sup>

The use of dollar values provides a consistent 'measuring rod' with which to compare costs and benefits. Monetisation relates not only to costs/benefits that are naturally

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<sup>2</sup> [CBAX Spreadsheet Model | The Treasury New Zealand](#)

<sup>3</sup> For example, the New Zealand Transport Agency undertakes CBA that includes values for various transport-related impacts, such as time travel savings, noise, and injury and death. See [Monetised benefits and costs manual v1.7.2 November 2024](#)

denominated in dollars, but also to other impacts such as environmental and health impacts. Economics has developed robust methodologies to assigning dollar values to such impacts.

If impacts cannot be monetised, they can often still be measured in some way. Regardless, they should be identified and disclosed to aid transparency. If monetisation is only possible for one side of the ledger (say, for costs), an approach known as 'breakeven analysis' can be used. This involves using the monetised costs to determine how high the non-monetised benefits would need to be to exceed the costs, and making an informed judgement on how plausible those benefits are.

**Step 4: discount and compare benefits and costs in present-day values:** costs and benefits often occur in different years, but it is not appropriate to treat dollar values in different time periods as having the same weighting. This is because of the 'time value of money': one dollar today is worth more than a dollar tomorrow, because the former can be invested or consumed to provide greater value. Discounting is used to compare impacts in different time periods, which converts an impact into a present-day value using an appropriate discount rate.<sup>4</sup> The Treasury provides guidance on the appropriate public sector discount rates for agencies to use.

Having discounted all values to a present value, the overall net benefit can be calculated as the 'net present value' (NPV). The NPV is the sum of the discounted benefits minus the sum of the discounted costs.

**Step 5: account for uncertainty:** benefits and costs used in CBA are always predicted future values, based on assumptions as to the expected impact of a regulatory change. There will therefore always be some uncertainty over the benefits and costs.

There are various ways to account for this uncertainty. One way is to use ranges for specific unknown values. For example, a regulatory change may be expected to result in time savings for compliance, and while a precise value for these savings is unknown, a reasonable range may be 10 to 20 hours per year. Another approach is to conduct sensitivity testing. This involves varying each assumption within a plausible range, and considering how sensitive the overall NPV result is to variation in that assumption (for example, does variation in a given assumption change a net benefit into a net cost?). As well as varying each assumption individually, scenario analysis can also be undertaken, which involves considering if a combination of plausible changes to each assumption reverses the sign of the NPV. Other more sophisticated approaches to account for uncertainty include constructing confidence intervals (giving a range in which, loosely speaking, the analyst can be confident to a certain percentage that the true estimate

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<sup>4</sup> The formula used to convert a dollar impact  $I$  incurred in time period  $t$  into a present-day value is  $PV = \frac{I}{(1+r)^t}$ , where  $r$  is the discount rate.

<sup>5</sup> See [Discount Rates | The Treasury New Zealand](#)

lies within the range) and Monte Carlo simulation (using statistical sampling to draw a plausible range of values from a given distribution).

**Step 6: identify distributional impacts:** The implicit framework underlying CBA is that if the benefits of a regulatory proposal exceed its costs, then society (in aggregate) is better off. However, the costs and benefits of a regulatory proposal fall on different groups. For example, while the benefits of a proposal may exceed the costs, the benefits may accrue to higher-income earners, while the costs fall on lower-income earners. It is important to explicitly identify who gains and who loses, and by how much. This makes these impacts transparent, and allows the ultimate decision-maker to consider whether net benefits are large enough to justify any undesirable distributional impacts.

## Summary

CBA is a technique that identifies and measures in dollar terms the full range of societal impacts from a regulatory change. In doing so, it provides a structured, transparent, and evidence-based approach to regulatory decision-making. Used proportionately and alongside other forms of analysis, CBA helps ensure regulatory decisions are analytically rigorous and deliver net value to society.

# **RSA Economics underpinnings guidance – problem definition and options identification**

Draft

27 January 2026

## **Introduction**

This document is intended to provide additional support to agencies to the Guidance issued under section 26 of the Regulatory Standards Act 2025. It will provide support in:

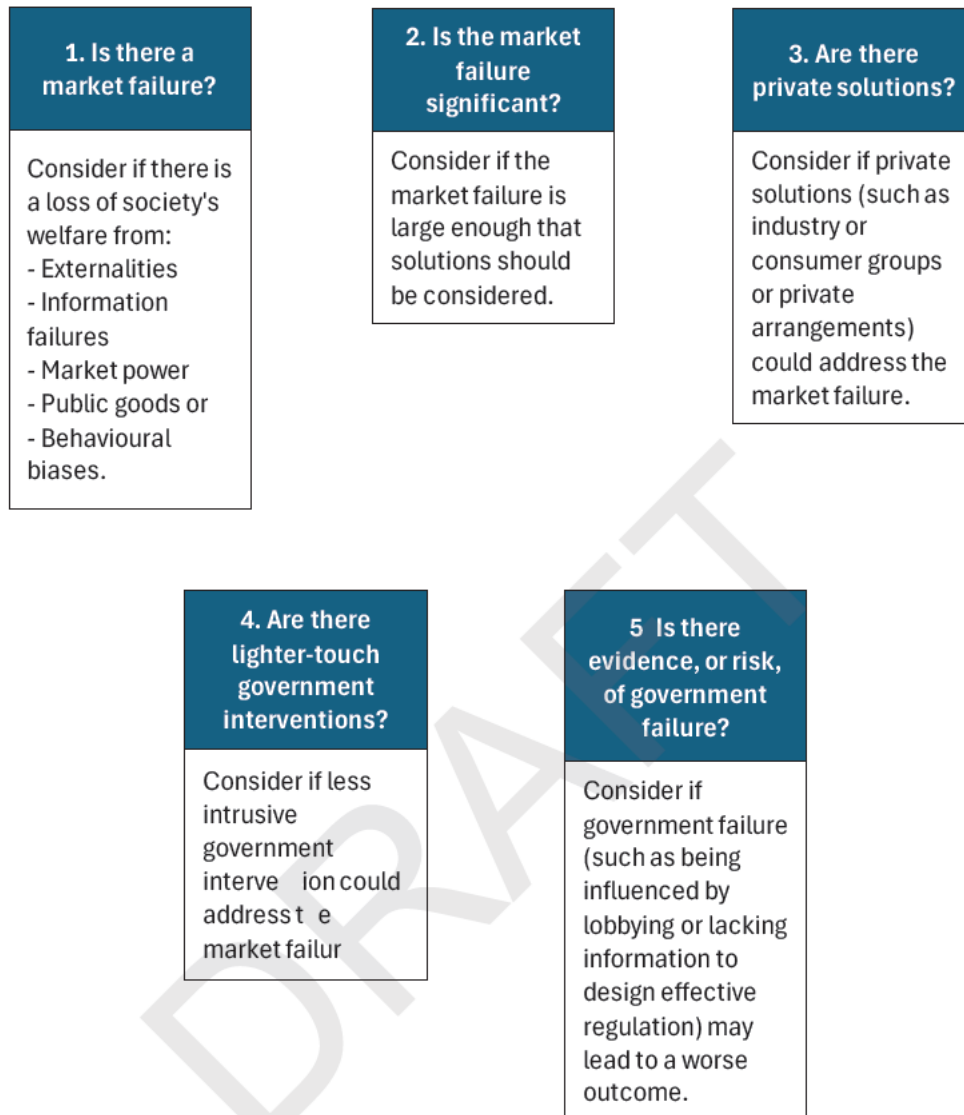
- Early policy development;
- When preparing a Consistency Accountability Statement; and
- When preparing a Regulatory Analysis Summary.

The specific focus of this document is on problem definition and options identification: the identified problem that government intervention is seeking to address and the options available to address it. The related provisions of the Regulatory Standards Act for problem definition are 9(j)(i) and 9(j)(iii), regarding the evaluation of the issue concerned and whether the public interest requires that the issue be addressed. For options identification, the related provisions are 9(j)(i) regarding the effectiveness of existing legislation and common law, and 9(j)(iv) regarding options (including non-legislative options) to address the problem.

Many problems that warrant government intervention can be characterised as market failures. Economists define a market as a collection of buyers and sellers that voluntarily interact to exchange a particular product. In many situations, markets deliver socially desirable outcomes. However, some circumstances cause "market failure", meaning the market does not maximise the collective welfare of society. Correcting a market failure, such as through government intervention, can therefore be in the public interest. Government intervention can also be used to correct previous interventions that, even if well-intentioned, decrease society's welfare (known as government failure). Agencies can follow the step-by-step guide in Figure 1 to assess market failure and government failure. This document will explain this in more detail.

Regulation may also be used, for example, to establish or clarify property rights, to enforce common law rights, to set standard units of measurement, for equity or distributive reasons, or to achieve broader social objectives. Such objectives are not explored in this note, but may warrant consideration when analysing government intervention.

Figure 1: Step-by-step guide to assessing market failure and government failure



## Step 1. Is there a market failure?

A market is a collection of buyers and sellers that voluntarily interact to exchange a particular product. Economists agree that, under certain conditions, markets are the most efficient means of allocating resources. 'Most efficient' here refers to economic efficiency, and means the collective welfare of society is maximised.<sup>1</sup> Put differently, markets yield outcomes that are in the public interest. The implication is that

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<sup>1</sup> Welfare refers to more than just direct financial outcomes such as income. For example, it includes the value of health and safety, environmental quality, and cultural and social impacts.

government intervention in markets should be approached with caution and supported by clear and robust evidence.

However, when certain conditions are not met, markets may not maximise welfare. The situations that cause these conditions not to be met are known as market failures.

***Market failure: one of a set of situations that cause a market to result in economically inefficient outcomes, leading to a loss of society's welfare.***

Economists identify the following situations as market failures:

- **Externalities:** an externality is a cost or benefit resulting from one party's activities that falls on an uninvolved third party. This cost or benefit is not incorporated (or 'internalised') in the decision-making of the original party. As a result, activities with negative externalities (spillover costs) occur more than is socially optimal, and activities with positive externalities (spillover benefits) occur less than is socially optimal, both of which lead to outcomes that fail to maximise social welfare. Examples of negative externalities include air and water pollution, noise pollution from neighbours, health effects of passive smoking, and traffic congestion. Examples of positive externalities include knowledge spillovers from research and development and herd immunity from vaccinations.
- **Information failures:** information failures occur when parties in a market do not have full or accurate information, including information asymmetries when one party to an exchange has better information than another, which can lead to decisions that fail to maximise welfare. Information failures include asymmetries in knowledge of product quality, an inability for a paying party to observe a paid party's performance ('principal-agent' problems), insufficient information to coordinate decision-making ('coordination failure'), and insufficient information to foresee all possible events (leading to 'incomplete contracts').
- **Market power:** market power is when a business can raise prices (or lower quality) above competitive levels without being constrained by competition from its rivals. Market power can lead to an inefficiently low quantity being traded in the market, where some units are not produced even though their value to consumers would be greater than the cost of producing them. It can also reduce the incentives on the business to innovate and seek efficiency gains and quality improvements. All of this can result in a reduction in society's welfare.
- **Public goods:** economists use the term 'public good' to describe a good with two specific features: it is 'non-rival', meaning use of the good does not reduce its availability to others, and 'non-excludable', meaning consumers cannot be prevented from using it. Examples include public parks, street lighting, biosecurity, and national defence. These properties mean people have an incentive to free ride on the payments of others, such that the market will provide less of a public good than is socially optimal. Some goods, while not technically

public goods because they are either rival or excludable, raise similar issues. An example is a common pool resource (such as fisheries) which is non-excludable but rival due to resource limits. This can lead to the 'tragedy of the commons', where the resource is over-used and can become depleted.

- **Behavioural biases:** the standard theory of economically efficient markets assumes people maximise their individual welfare, which is referred to as 'rational' behaviour. However, economic research shows people are often subject to behavioural biases, where they do not behave fully rationally. Examples include where people overvalue the present relative to the future, such as by not saving enough or harming their future health, where their decision-making is simplified in the face of complexity, or where they disproportionately choose the status quo or default option. In this way, people impose costs on themselves (known as 'internalities') that lower society's welfare.

Having discussed what *is* a market failure, it is worth also considering what is *not* a market failure. Even if market outcomes are 'wrong' according to a particular person's preferences or values, this does not necessarily indicate a market failure. For example, some people claim the provision of intensified housing such as 'shoe-box' apartments is evidence of a market failure. In itself, it is not. Although people who make such claims may not want to live in such apartments, it is likely many other people would choose less space to pay a lower price. If they did not, it would not be worthwhile for developers to build such apartments.

High prices do not necessarily indicate a market failure. Some goods and services are expensive to produce. If firms could not charge high prices for them, they would not supply them at all. Price spikes in response to natural disasters or supply shocks are also not evidence of a market failure. If anything, they suggest the market is working well, because the high prices ration demand when supplies are limited (albeit government may intervene for other reasons in the case of natural disasters).

**The first step in evaluating problem definition is to identify any market failures.** That is, what (if any) of the above situations are likely to be occurring in any market(s) of relevance to the policy problem. Market failures can occur in existing markets, either because the market is unregulated or because current regulation does not address the market failure. If new regulation is being proposed, consideration should be given to whether it is addressing a genuine market failure. If regulation is being changed or removed, consideration should be given to what market failure it was intended to address (if any).

There should be good evidence for any identified market failure. Evidence of existing market failures may come from views expressed by market participants or empirical data. Examples of evidence include environmental damage (arising from externalities), consumer concerns (arising from information failures), and evidence of competition

problems (reflecting market power). Market failures observed in similar markets overseas can also provide evidence. Empirical evidence can be supported by theoretical arguments, drawing on relevant economics literature.

The concept of risk, such as health and safety risk, often arises when considering market failure. Risk arises in a number of ways, and society uses various approaches to manage it. Regulation is just one approach. Risk can often be framed as a market failure, such as in terms of information failures (people have inadequate information to assess risks), externalities (the broader social costs of harm may not be fully borne by an individual undertaking a risky action), market power (reflecting a power imbalance between employer and employee), public goods (in the provision of health services), or behavioural biases (through biases in risk beliefs). More generally, risk may arise because of 'missing markets', where no such market mechanism exists to adequately allow market participants to appropriately manage risk.

It is not always obvious whether a problem in a market is evidence of a market failure, the unintentional result of regulation, or both. For example, market power may be caused by regulation that makes it hard for new businesses to enter and win market share. It is therefore important to identify the root cause of a problem, and the role existing regulation might play in creating it. The latter point is discussed in more detail in Step 5.

## **Step 2. Is the market failure significant?**

Market failures are ubiquitous. For example, externalities are everywhere, from the noise fellow passengers make on public transport, to the close proximity of residential neighbours, all of which can impose spillover costs on third parties. Information problems are also plentiful. For instance, consumers can never truly have perfect information on a product's pros and cons prior to purchase. And nearly all firms have some degree of market power and ability to influence prices.

However, many market failures are too immaterial to warrant a corrective response.

**Step 2 therefore involves considering the materiality of any potential market failure: is the effect on the welfare of society large enough that solutions should be considered?**

An assessment of materiality will be somewhat subjective. However, rigour and transparency can be increased by drawing on the information used in Step 1, such as evidence from market participants, empirical data, overseas markets, or economics literature.

## **Step 3. Are there private solutions that address the problem?**

Where significant market failures exist, regulation is not the only solution. An option to address the problem may be to do nothing, and allow private solutions, including those

using private contracts and established common law, to emerge to help guide the market back towards the efficient outcome. For example, warranties, online reviews, and consumer groups can lessen asymmetric information about product quality. Businesses can invest in developing brands, nationwide chains, or franchising to signal quality and reduce the effects of information failures. Private negotiations between affected individuals can address externality problems. Industry groups can help resolve market failures through self-regulatory mechanisms, such as voluntary certification and industry standards to indicate business quality. Market failures can also be addressed through social norms or may naturally resolve over time through the competitive interaction of industry players.

It is important to evaluate the option of doing nothing, and carefully consider what might happen if the private market is left to resolve the situation on its own without government intervention. Private solutions can be preferable to regulation, because they avoid the compliance costs and distortions to incentives that arise from regulation. They also avoid the costs of establishing and monitoring a regulatory regime, and can be more flexible and adaptable to changing circumstances.

**As part of the options identification, Step 3 the reform involves assessing whether private solutions (i.e., doing nothing) could address the market failure absent government intervention.** This involves gathering evidence on whether any existing market solutions address the problem, or could better address it if improved. Any private solutions that have emerged in similar markets overseas should be considered, as should potential solutions identified in academic research. Sometimes regulation ‘crowds out’ private solutions, preventing them developing, so the assessment should look for any evidence that existing regulation has done this. It is also important to consider if regulation can facilitate private solutions, such as through clarifying property rights or lowering transaction costs to better enable market participants to resolve externality or information problems.

#### **Step 4. Are there ‘lighter-touch’ government interventions?**

Government interventions to address market failures range on a spectrum, from lighter-touch (more indirect) solutions that can impose less cost on regulated parties and allow greater flexibility in their responses, through to more intrusive, direct requirements. Examples of lighter-touch interventions can include taxes or subsidies, tradable rights schemes, mechanisms to enable the provision of information, and tools to alter people’s choices to address behavioural biases (known as ‘nudges’). Guidance is also an alternative to more prescriptive regulatory requirements. Compared with indirect regulatory approaches such as price signals, direct mandates can provide weaker incentives for behavioural change, and be a less cost-effective way, or simply a less effective way, of addressing market failure.

**As part of the options identification, Step 4 involves considering if a lighter-touch regulatory solution could address the market failure.** This recognises that regulation imposes costs and should be proportionate to the problem it addresses. Evidence from step 2 on the materiality of the market failure problem can inform this analysis. Academic research and overseas practices can provide insight into potential lighter-touch regulatory tools.

### **Step 5. Is there evidence, or risk, of government failure?**

While governments are generally well-intentioned in addressing market failures to increase society's welfare, their incentives and information mean they can fail to achieve this or create unintended consequences. As a result, government intervention may inadvertently create a larger loss of society's welfare than results from the market failure. It is important to avoid the 'nirvana fallacy', when an imperfect market outcome is compared with a nirvana in which regulation perfectly addresses the market failures.

Like market participants, elected politicians and government bureaucrats are humans with their own incentives. They may be seeking re-election or to expand an agency's influence or budget, or being influenced by lobbying to put the interests of specific parties above those of society (that is, they may be subject to 'regulatory capture'). Public pressure to be seen to be addressing an issue or agency incentives to expand their role can create a risk of 'regulatory creep', where the scope and depth of regulation grow over time. Furthermore, governments may not have sufficient information to determine the optimal response to a market failure, because that information is dispersed across society and constantly changing.

All these effects are examples of government failure, which skew outcomes away from those that are welfare-maximising.

An assessment of government failure can be approached in two ways. First, addressing government failure in existing regulation can provide a valid rationale for government intervention (instead of, or even in addition to, a market failure rationale). That is, if there is evidence that existing regulation is leading to a welfare loss from government failure, changes to regulation may be warranted. Second, any proposed regulation should also be assessed as to whether it creates a risk of government failure.

**Accordingly, step 5 involves assessing the evidence that existing or proposed regulation could lead to lower welfare for society due to government failure.** For existing regulation, this can involve considering whether problems may be arising because of the behaviour of those in government (as opposed to market participants). For both existing and proposed regulation, evidence can come from academic research assessing if the regulation has a high risk of government failure. Another consideration is whether well-organised interest groups exist that can (or do) effectively lobby to water down any regulation. The extent of information government officials require to design

effective regulation also matters. If information requirements are high relative to information availability, government failure is more likely. As with market failure, the size of the problem matters. A government failure that is immaterial or unlikely is of low concern.

## **Summary**

The above steps provide a basis for identifying the problem that government intervention (including a change in the level/nature of government intervention) is seeking to address, based on the concepts of market failure and government failure, and identifying the preferable option to address that problem. The approach can be summarised as first asking 'is there a material problem that cannot be solved by market behaviour?', then considering the appropriate solution to address that problem. Applying this approach gives a more rigorous, evidence-based approach to analysing proposed new regulation, which mitigates the risk of poor regulation.

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