

Guidance Note

Best Practice Impact Analysis

June 2017

INTERIM VERSION - UNDER REVISION

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Introduction

This Guidance Note describes the key elements of the Impact Analysis Framework. These elements should underlie the development all government policy initiatives which involve proposals to create, amend or repeal primary or secondary legislation (a 'government regulatory proposal'). This is an interim product.

The material in this document has been adapted from the former Regulatory Impact Analysis Handbook. That Handbook was written in 2013 and there are practices and methods that we can improve on. Treasury will work in partnership with the Head of Policy Profession's Policy Project and with regulatory system stewards to improve our practice advice, and in due course replace this Guidance Note and the Consultation for Impact Analysis Guidance Note. Input and feedback from your agency is also welcome.

Further information

The formal requirements for all government regulatory proposals are set out in the Cabinet Office circular: CO(17)3: Impact Analysis Requirements available at dpmc.govt.nz/publications/co-17-3-impact-analysis-requirements: There is further guidance in the revised Cabinet Manual, available at dpmc.govt.nz/our-business-units/cabinet-office/supporting-work-cabinet/cabinet-manual.

The Guide to Cabinet's Impact Analysis Requirements provides guidance on how to meet the formal requirements for regulatory proposals. The Guidance Note on Effective Consultation for Impact Analysis also provides useful guidance on the policy development of regulatory proposals. Both are available on Treasury's Regulation webpage (treasury.govt.nz/regulation/impact-analysis).

1. The Purpose of Impact Analysis

The purpose of Impact Analysis is to help achieve a high quality regulatory environment by ensuring that regulatory proposals are subject to careful and robust analysis. Impact Analysis is intended to provide assurance about whether problems might be adequately addressed through private or non-regulatory arrangements—and to ensure that particular regulatory solutions have been demonstrated to enhance the public interest.

The results of your Impact Analysis should be summarised in a Regulatory Impact Assessment and provided to Cabinet when seeking policy approvals. This is a government agency document which summaries an agency's best advice on the Impact Analysis relating to a government regulatory proposal.

Impact Analysis summarised in a Regulatory Impact Assessment (or RIA) can serve two benefits:

- **Enhancing the evidence-base to inform decisions** about regulatory proposals—to ensure that all practical options for addressing the problem have been considered and that the benefits of the preferred option not only exceed the costs but will deliver the highest level of net benefit, and
- **Transparency**—the presentation of agencies' free and frank advice to decision-makers at the relevant decision points provides reassurance that the interests of all sectors of the New Zealand public have been considered. Impact Analysis also aims to encourage the public to provide information to enhance the quality of regulatory decisions, to further inform the evidence-base.

2. The Impact Analysis Framework

The following guidance is detailed because Impact Analysis is expected to deal with various policy problems and a 'one-size-fits-all' approach is not possible. Good Impact Analysis is essentially just robust policy development within a transparent framework, so several factors will be relevant to particular regulatory proposals. The detail in this guidance should not suggest that a resulting Regulatory Impact Assessment (as a summary of the Impact Analysis) should be lengthy and overly detailed.

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2.1. Describe the status quo (or counter-factual)

Impact Analysis involves assessing one or more policy options against the situation expected to occur in the absence of any **further** government action or decisions (the status quo).

The description of the status quo should cover the following key features of the current situation.

Features of the market or relevant social arrangements

The description of the status quo should include consideration of the relevant prevailing market conditions or social arrangements. This may, for example, include expected demand and supply trends, and other features or characteristics such as relevant market participants or agents. This means identifying the producers, suppliers, retailers, consumers, beneficiaries, regulators, any other interested parties, and describing their interests.

Impact Analysis needs to be forward-looking in order to assess alternative options for dealing with a problem over time. It is therefore useful to identify how the status quo is likely to change over time without further intervention—rather than simply providing a static snapshot.

Existing legislation/regulations

The status quo should describe any existing legislation/regulations, or other relevant government interventions or programmes that are in place.

If there are non-regulatory, self-regulatory, or co-regulatory arrangements in place, these also form part of the status quo. The description should be detailed enough to enable an interested (but non-expert) member of the public to understand:

- who are the relevant parties and institutions—both public and private, regulators and regulatees, quasi-governmental, unions or clubs, and charitable organisations, etc
- what are the different incentives and observed behaviours of those parties and institutions, and
- what are the tools or resources those parties and institutions currently have available.

Any relevant decisions that have already been taken

Any relevant decisions that have already been taken should also be taken into account, including decisions that have been agreed by Cabinet but for which the legislation has not yet been passed.

If Cabinet has previously considered a proposal, for instance by directing or limiting scope for officials starting work on an issue which is in its early stages, prior decisions should be described in the status quo of the Regulatory Impact Assessment. Previous related Regulatory Impact Assessments should be briefly summarised and referenced so that the public can follow the overall Impact Analysis.

Confidence and supply agreements

Confidence and Supply agreements generally commit to specific policy options to achieve set objectives. These commitments are outside the Cabinet decision making process.

The analysis undertaken by Agencies in these situations usually focuses on design and implementation issues for the stipulated option. However, the Regulatory Impact Assessment should at a minimum include information on:

- the merits of the policy objectives (if any) sought to be achieved by the specific commitment in the confidence and supply agreement
- the nature of the policy problem that is being addressed, and
- any alternative options for achieving the objectives / solving the problem that were not considered because of directions as to the scope of the policy process, and whether any of them might better achieve the objectives / solve the problem.

In some circumstances a full analysis will be both feasible and desirable—and may already have been undertaken by the Agency. In such cases, and where the issues at stake are significant, the Regulatory Impact Assessment should include the full analysis. The Regulatory Quality Team should be consulted where there is any doubt about the Regulatory Impact Assessment to be prepared in these circumstances.

2.2. Define the problem and assess its magnitude

Impact Analysis requires a problem to be identified. Having *described* the status quo, the next task is to assess the nature and size of the problem associated with the expected outcomes in the absence of any further government action. A good problem definition will explain the gap between the current situation (what officials expect to be the status quo projected over the period of analysis) and the outcome that the agency is aiming for (as described in the objectives). Problems should be couched in terms of public interest, broadly considered.

A problem definition will be the *prima facie* case for regulatory intervention and the reason for discussing options. The problem should be able to be summarised in a pithy sentence.

Size of the problem

The problem definition needs to do more than identify the gap between status quo and objectives: it should discuss its size and importance. This involves identifying the *costs and benefits* of the current arrangements, including:

- the nature and probability of the adverse outcome/s that will arise in the absence of further government intervention (in addition to the interventions already in place), and
- who is likely to be affected by the adverse outcome, including how widespread it is likely to be (ie, how many individuals, groups, firms etc. are affected), what harm or injury is likely to occur, and the magnitude of these impacts.

Not everything can or should be valued in monetary terms, but quantification should occur to the extent possible. For example, if the problem is related to economic efficiency, how much is at stake? If equity-related, what is the current distribution of costs and benefits? If an environmental problem, what is the potential effect of not acting and what are the overall costs? This quantification should include aggregate figures (totals) to help put the issue in a wider perspective.

Distinguish between causes and symptoms of problems

The next step is to identify the **root cause** of the problem (not just the symptoms), for example market failure, regulatory failure, unacceptable hazard or risks, social goals/equity issues. Detail should be provided as to the nature of the problem—for example, if the market failure is a result of information asymmetries, the problem definition needs to identify who is unable to access what information and how their behaviour results in evidence of a problem.

The reason why the problem will not be addressed within existing arrangements or by private arrangements (such as individual contracts, market forces etc.) should be explained. If the problem relates to existing legislation or regulation, it should be made clear whether the problem is in relation to its **design** or its **implementation**, or both.

In practice, the status quo and problem may be inter-related and considered or discussed together. For instance, the problem may be best expressed by describing how policy objectives are not being met. However, the key elements of both should be addressed.

Identifying and diagnosing problems

Voluntary arrangements between parties are often the best way to promote the long-term interests of consumers, employees, entrepreneurs, investors, government and wider society. However, there are circumstances when voluntary transacting can fail. Good problem definition requires an understanding of the failures that can arise from voluntary transacting, and self- or co-regulatory initiatives, and government regulatory arrangements:

Imperfect competition—where one or more party is able to control a market for their own benefit at the expense of consumers or other firms.

Information problems—where one party to a transaction does not have the information needed to act in their best interests. In extreme circumstances this can lead to significant costs to many parties and the market being under-developed because of a lack of trust.

Externalities (spill-overs)—where costs or benefits fall on people other than those who consume the good or service. This can lead to the over- or under-provision of the good or service, and

Public and mixed goods—where a good or service is:

- *under-supplied*, because it cannot be charged for
- *under-consumed*, because consumers are being directly charged but their consumption is not incurring extra costs, (ie, it non-rivalrous), or
- *over-consumed*, because there is free access to the resource but consumption still imposes costs.

Lack of clear property rights—unclear, ill-defined, or poorly designed property rights can mean that parties do not bear the consequences or receive the rewards that result from their actions.

Self- or co-regulatory arrangements can go some way to correcting these failures, but there are risks that other problems are created. The regulatory body might be captured to promote the interests of its members at the expense of the public (rent-seeking), in particular where members have strong market power. Such arrangements may lack legitimacy and credibility (thereby undermining effectiveness), or lack the capability and capacity to deal effectively with new or emerging problems.

The problem may relate to current regulation and previous attempts to manage risks. The government can fail where it lacks the capability or information, or has poor incentives to do a better job than voluntary and self- or co-regulatory arrangements. As well as each of the above problems, direct regulation can risk leading to further problems with:

Unintended consequences—by inducing behaviour or providing incentives that do not improve welfare

Inefficient regulatory enforcement—in the absence of market pressures, there may be a risk of institutional failure. For example, regulatory activity might not reflect the current preferences or risk-tolerances of the public

Moral hazard—making the market less responsive to competitive pressure by giving an implicit guarantee of government support or protecting incumbents from competition

Crowding-out—a reduction in private economic activity due to complying with regulation

Rent seeking behaviour—government involvement can open the door to political lobbying to be given a share of wealth that has already been created. As with crowding-out, this activity distracts from creating new wealth.

2.3. Define the objectives

The objectives should summarise the Government’s policy intentions, but also inform how any potential regulatory solution will be evaluated for effectiveness.

The objectives, outcomes, goals or targets that are sought in relation to the identified problem should be described. These may be a restatement of the current policy objectives if they are relevant to the status quo, or they may be particular to the problem identified in the previous section—it is important to state the objectives of any current policy arrangements and whether those objectives have changed as a result of identifying a problem. If there is an authoritative or statutory basis for undertaking the analysis eg, legislative requirement to annually review an item of regulation, this should be explained.

The objectives should be clear and should not pre-justify a particular solution. They should be specified broadly enough to allow consideration of all relevant alternative solutions. It may be appropriate to distinguish between primary and subsidiary objectives. The objectives should focus on the desired final outcome rather than the means of achieving it, but should allow the consideration of all feasible alternative options. If they do not, the objectives are likely to be too narrow.

There is usually more than one policy objective, meaning there may be potential for conflict between objectives. Balancing objectives may reflect that regulating is not costless, or that there are multiple outcomes expected by society. It should be clear how trade-offs between competing objectives are going to be made and the weightings given to objectives—not just those in direct conflict. The Treasury’s [Living Standards Framework](#) provides one example of how to think about trade-offs and how to incorporate social aims into regulatory objectives¹.

There may also be a hierarchy of objectives, particularly when the desired high-level policy outcomes cannot be directly measured. More specific assessment criteria and observable targets should be used to measure progress towards achieving policy objectives. If the outcomes are subject to constraints, for example if they must be achieved within a certain time period or budget, then these should be clearly specified in the statement of objectives.

Stating the objectives should also provide scope for the subsequent impact analysis. What questions will officials be asking themselves (and what information will Ministers need) when ranking options?

¹ The Treasury’s Living Standards Framework can be found online at: <http://www.treasury.govt.nz/abouttreasury/higherlivingstandards>

2.4. Identify the full range of feasible options

Identify the full range of policy options that may fully or partially achieve the stated objectives and thereby address the identified problem. This should include both regulatory and non-regulatory options. Within regulatory options, a representative and pertinent spectrum of viable regulatory forms should be considered.

If the range of options has been previously limited by Cabinet or by specific Ministers, this should be made clear as part of describing the status quo.

If the range of feasible options for responding to an identified problem has been restricted without a formal Cabinet decision, the reasoning behind this direction should be explained by setting out the policy objectives in the Regulatory Impact Assessment. Where policy work has been limited without detailed analysis, the agency may need to outline the implications of this in the Regulatory Impact Assessment.

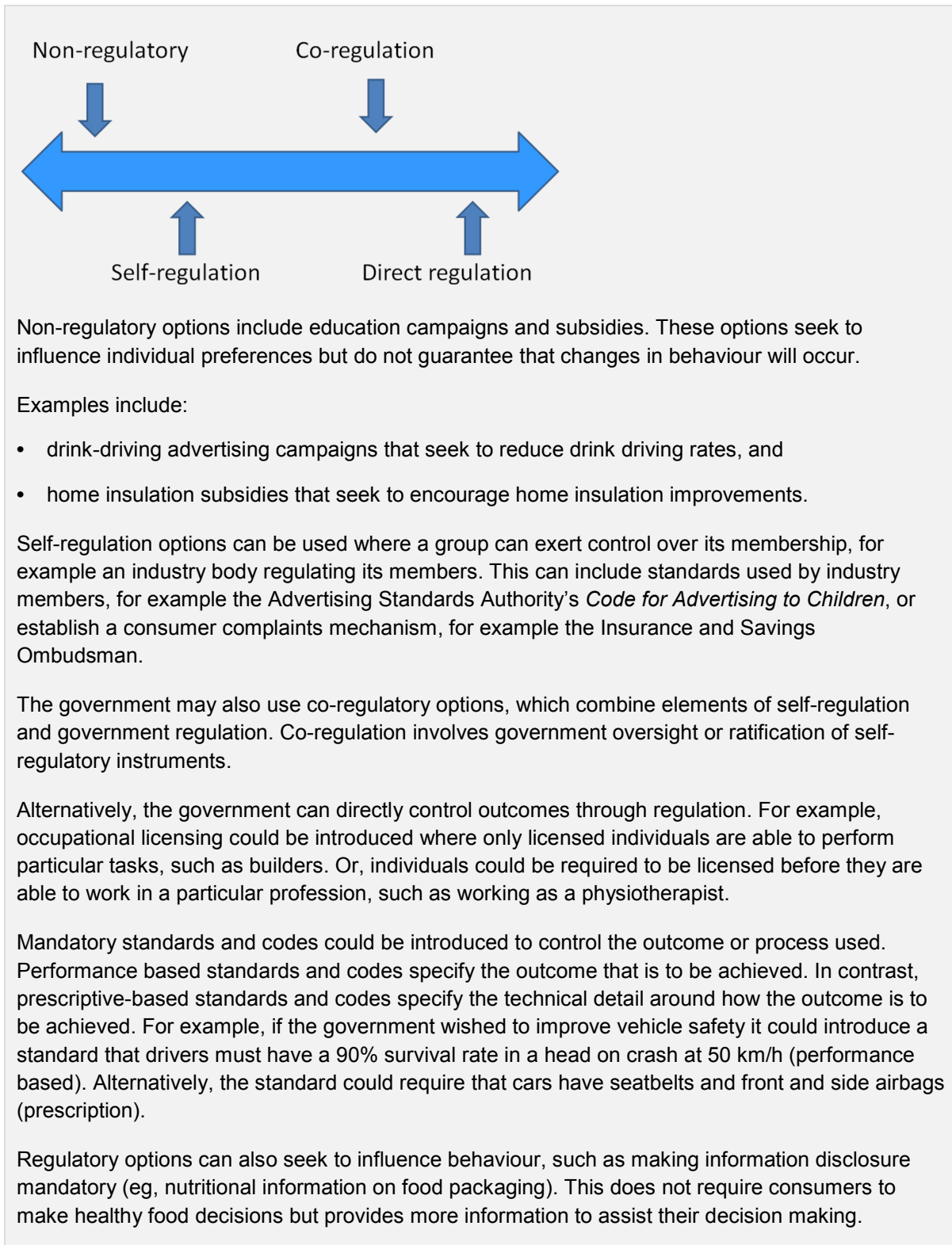
It is not always possible to analyse every possible combination or permutation of policy tools within options—there might be an infinite range of options. Unless past decisions limit the set of options that can be considered, Impact Analysis should identify and describe:

- the status quo scenario projected forward—where no further regulatory changes occur (behaviour may still be expected to change over time)
- one or more non-regulatory options (eg, education, industry self-regulation)
- one or more regulatory options, and
- what would happen without regulation or government intervention (if different from the status quo).

If deliberately excluding feasible options, or options that affected parties are likely to think are feasible, the Impact Analysis (and subsequent Regulatory Impact Assessment) should explain why. If these exclusions or restrictions would lead to any shortcomings in the analysis, or increase the risks or making the decision, this should be noted in the relevant part of the template of the subsequent Regulatory Impact Assessment.

Regulatory alternatives

A variety of regulatory and non-regulatory instruments are available to achieve the government's objectives. Selecting the right instrument will depend on the problem to be addressed and the overall policy objective.



Alternatively, the government can regulate more directly, by prohibiting certain conduct or actions. Drink driving offences are an example of this, where driving with over 80 milligrams of alcohol for every 100mls of blood is prohibited.

In many cases, there will not be one answer and a number of instruments used in conjunction may be the most effective way of addressing the problem. For example, education campaigns can be used to increase compliance with legal requirements such as the blood alcohol limits while driving.

Levels of analysis

Generally speaking, the level of analysis undertaken (detail and depth) should be commensurate with the magnitude of the problem and the size of the potential impacts of the options being considered. There is often judgment required to determine how much analysis is appropriate in particular circumstances and the Regulatory Quality Team can provide advice on this.

Sometimes it is appropriate to narrow down the initial range of options, and undertake comprehensive analysis on a more limited set of options, as this enables analytical resources to be focused on those options most likely to deliver net benefits². In these circumstances, the objectives against which the full range of options was assessed should be explained, and the way they were applied made explicit (eg, if any objectives were weighted more highly than others). An example of this process is where a multi-criteria analysis³ is employed to narrow down the set of options subject to full cost benefit analysis. Initial options may also be narrowed down through early consultation processes.

New regulation should not conflict with or duplicate existing legislation or regulations. It is therefore also important to consider how a regulatory option will interact with the stock of regulation, including whether there is scope to reduce or remove any existing regulations.

² If there is a preferred option, the greatest effort should go towards analysing this, and the second-most preferred option.

³ Multi-criteria analysis is a way of appraising and ranking policy options against a given set of objectives or criteria. It is not an alternative to cost benefit analysis since it evaluates options' likely effectiveness in achieving the objectives—rather than the overall efficiency from a New Zealand net-public benefits perspective.

2.5. Analyse the options

Having identified the full range of feasible options, the next step is to analyse the costs, benefits and risks of each option. The analysis needs to show how each option would alter the status quo, which option is likely to be the most effective for solving the problem, and which option has the highest net-benefit.

Options analysis should be the fundamental concern of any decision about whether to regulate and in what way. All options analysis must aim to answer:

- How does the option broadly measure up against the objectives? Answering this question may require a full impact analysis of each option.
- What is the net impact (or net benefit or cost) of taking any of the available options?
- What are the distributional implications of the options being considered? Options analysis requires evidence and analysis of who wins and who loses—and by how much.

The options analysis should structure the analysis on the different elements of the problem. This may require identifying the particular decision-points and different policy tools within an option that might address discrete elements of the broader problem. This requires an appropriate framework for analysis.

Where the problem is related to particular risks, these should have been clearly identified. The options should describe how those risks would be:

- voluntarily accepted by those bearing the consequences of any risk, eg, requiring participants to sign waivers of liability
- transferred to other parties, eg, making certain parties liable for consequences of their actions (such as advice to uninformed clients)
- mitigated (reduced in likelihood or consequence), eg, by mandating safety equipment to minimise the injuries that could be sustained, or
- avoided, eg, prohibiting the activity which could lead to the risk.

Identify the full range of impacts

This stage involves identifying the full range of impacts, and providing a qualitative description or explanation.

Impacts can be positive or negative (ie, include both costs and benefits), and include economic, fiscal, compliance, social, environmental and cultural impacts. They include direct and indirect (flow-on) effects; one-off and recurring or on-going impacts. Impact Analysis needs to identify whether an option would increase or decrease the net-benefit to society compared with the status quo.

Discrete impacts should be separately described and accounted for:

- **Economic impacts** include the dynamic effects on overall welfare and reflect changes to overall production and consumption. They are relevant to gauging overall efficiency by considering whether the behaviour of consumers, business, and the community might be:
 - a) Altered positively to achieve the objectives or create other net-benefits to society, or
 - b) Distorted with negative consequences—creating opportunity costs. Welfare losses can arise from regulation which impairs competition, stifles innovation, artificially constrains pricing or valuation decisions, or generally restrains the economic activity of individuals and firms (eg, by distracting people from more productive endeavours).
- **Fiscal costs** are borne by public agencies (and ultimately, the taxpayer) in administering the regulation or law. They include the costs of implementation, formulating standards, monitoring and enforcing compliance, and adjudicating disputes or administering appeals.
- **Compliance costs** are the direct costs that regulated parties will face in order to comply with regulatory options. They include the cost of collecting and reporting information, equipment purchases and the development of new processes and reporting systems.

Compliance costs are usually the most prominent and identifiable impacts. However, while they may affect individual or group behaviour, compliance costs may be less significant from a net economic benefit (society-wide) point of view. Cost estimates in options analysis are likely to be subject to assumptions about how regulatory options might be implemented or how businesses might choose to comply.

Consideration should be given to ways in which costs, particularly compliance costs, may be reduced or minimised. There may be trade-offs between compliance costs and the administrative costs to government—these should be explicitly identified. For instance, greater flexibility in the ways regulated parties could comply with regulatory requirements may minimise their costs, but may increase the costs of administering the regulation. The key informational requirements are set out in the following box. Key informational requirements for identifying compliance impacts

The specific costs on regulated and third parties should be separately identified from fiscal and wider economic impacts of regulation and should be tested with affected parties through consultation. Impact Analysis aims to make agency assessments of compliance cost impacts more transparent by identifying:

One-off costs, such as acquiring sufficient knowledge to meet the regulatory obligations, retooling production processes, purchasing or leasing additional equipment and buildings, legal/consultancy fees and training expenses.

Recurring and ongoing costs, such as staff costs or time, consumable materials, inspection fees/licences, costs imposed by enforcement processes, form filing (that is, costs arising from the need to devote additional time and resources to satisfying regulatory requirements).

The parties likely to be affected. If the costs will be borne by businesses, the sector and sizes of firms should be identified to give an indication of magnitude.

An assessment of the risks or uncertainties associated with cost estimates.

Overlapping compliance requirements with other agencies or regulatory regimes. It may be possible to design compliance processes so that information is shared between two related compliance processes.

Analyse the incidence of impacts

The incidence of the impacts of each option also needs to be assessed, that is, what would happen as a result of each option and who would be affected. While it may be appropriate to consider 'who' before 'what' or 'how', both the impacts and their incidence should be identified **before** the individual impacts are valued to determine net-benefits.

The different types of people and groups relevant to the analysis will vary depending on the options being considered. They may include:

- individuals, families and/or households
- consumers
- employees (including relevant contractors and sub-contractors)
- businesses (including those upstream and downstream in the supply chain)
- people who live in particular regions
- members of particular groups of the population (ie, ethnicities, genders, age groups etc)
- users of resources eg, recreational fishers, road-users
- not-for-profit organisations (including charities, voluntary organisations and incorporated societies)
- local government, and/or
- central government agencies.

It may be necessary to further distinguish within these groups (eg, within businesses by firm size or industry sector). The proportionate incidence of costs may be of particular relevance, eg, the impact on small businesses compared to total/average firms. The redistributive effects on income or wealth may also be of concern.

Assessing the impact of options on different parties should consider the competition effects—this may be done explicitly in evaluating an option against a policy objective (to 'promote competition' for instance), or as part of the analysis of who bears or receives costs and benefits. If an option is likely to have effects on competition, the Impact Analysis should consider (and the Regulatory Impact Assessment should summarise) the impacts on:

- **Incumbent Firms**—Will the option (eg, a proposed regulatory tool) affect companies differently, for example altering competitive relationships between them in a way that it will reduce competition in the market as a whole?
- **Entry of new firms**—Will the option restrict the entry of new firms? Will it affect competition in the long term?
- **Prices and production**—Will the option put upward pressure on prices by imposing new costs to producers?

- **Quality and variety of products and services**—Does the option include minimum standards that will reduce the range of price or performance combinations in the market?
- **Market growth**—Will the option affect the potential for parties, or the number of parties, to expand supply and meet more demand over time?
- **Related Markets**—Does the option affect related markets? That is, does it have effects on the production line?

Analyse the magnitude of impacts—and whether they are costs or benefits

Impacts should be quantified, and expressed in dollar terms (monetised) to the extent practical. This requires determining the number of individuals, firms or groups affected, the size of the impact on each of these, and the total impacts (ie, number affected multiplied by the size of impact). Quantification helps examine the costs of regulation and tests the assumptions and judgements involved in the formulation of policy advice. Monetisation enables comparison of options against each other and, by providing a common analytical denominator it helps avoid double-counting costs and benefits.

Quantification and monetisation is not always possible. In these cases, the costs and benefits should be described as fully as possible, drawing on any available qualitative evidence. Dollar figures should not be “invented” for their own sake.

All assessments of costs and benefits whether quantitative or qualitative, should be based on evidence, with data sources and assumptions clearly identified. If, for example, qualitative benefits are considered to outweigh monetised costs, the basis for this judgement should be explained.

Net impacts may not be easily expressed as monetary values, but the impact analysis should attempt to conclude what the **net** benefit (or cost) of each option is. Put simply, the net benefit (or cost) is the difference between total costs and total benefits.

In some cases, for example where costs and benefits will occur over many years, it may be helpful to identify a net present value (NPV) of the various options. The NPV is the sum of discounted net cash-flows, ie, the present value of costs less the present value of benefits. These concepts and how to calculate them are explained in detail in Treasury’s [Cost-Benefit Analysis Primer](#).⁴

It is crucial when evaluating net-impacts of each option to avoid double-counting. Some costs borne by certain businesses may be passed onto consumers, but the impact considered in the CBA should be the first order impact on businesses, rather than the second order impact on consumers. The likely flow-on effect on consumers should be described separately in terms of transfers and distributional implications—not quantitatively added to the business impact. Please see Treasury’s [CBA Primer](#) for guidance on quantification.

⁴ The Cost-Benefit Analysis Primer can be found online at: <http://www.treasury.govt.nz/publications/guidance/planning/costbenefitanalysis/primer>

Risk assessment

Impact Analysis requires an assessment of risks alongside agencies' conclusions about the relative merit and likely net benefit of the options. Some important types of risks to consider are set out in the Preliminary Impact and Risk Assessment template (see [Annex 1.1](#)).

Risks should be expressed in terms of how exposed each option is to future uncertainty. Some form of sensitivity or scenario analysis should be presented in the Regulatory Impact Assessment. A qualitative description of any risks and uncertainties—particularly for intangible costs and benefits—should also be given.

Risks should be identified for each of the affected parties. These might include the likelihood of compliance or of expected costs or benefit actually accruing. It might not be possible to estimate this probability with much precision—that is, there may be instances of true uncertainty. In that case, a risk analysis should assess the worst-case and best-case scenario, and comment on the likelihood of these extreme events.

Presenting the Impact Analysis

Separate rows or detailed descriptions in the option analysis section of the Regulatory Impact Assessment may be required to summarise how the different costs and benefits are borne by which parties. There are multiple possible tables that could be used to present the analysis, but below is one example:

Party	Benefits	Costs	Net impact	Risks (and likely effect on impacts)
Party 1	+	-	+/-	Describe
Party 2	+	-	+/-	Describe
Party 3, etc...	+	-	+/-	Describe
Total (net NZ)	Total benefits	Total costs	Net NZ welfare	Likelihood of net impact

An alternative way of presenting risks or uncertainties may include expressing net impacts as adjusted by a probability value. Expected values are calculated by multiplying the magnitude of an impact by the probability that it will actually be revealed. This may be a useful way of incorporating risks into the options analysis and is ideal where there is good quantitative evidence of potential impacts.

Where it is difficult to be precise about probabilities, colour-coding has previously been effective to show how confident an Agency is about projected impacts in an options analysis table.

The specific costs, benefits, and risks may be difficult to identify, and could be more accurately described as positive or negative 'impacts'. Where this is the case, the relative effectiveness of alternative options may need to be assessed in terms of how parties' behaviour might change. Incentive analysis is one method of comparing each option with the status quo. A simple framework is presented as an example below. This is another way of describing particular impacts (in this case behaviour)—but note that it may not be useful for capturing the total or net effects of an option.

	Incentive under Status Quo		Incentive under Option 1 (etc...)	
	Current Behaviour	Why?	Likely Behaviour	Why?
Party 1				
Party 2				
Etc...				

2.6. Consultation

The purpose of consultation is to provide confidence about the workability of proposals and that options have been properly considered. This section covers the basic process requirements for consultation on Impact Analysis —see *Effective Consultation* ([Part 3](#)) for general guidance.

To meet Cabinet’s Impact Analysis Requirements, agencies proposing new regulation must demonstrate consultation with affected parties on the problem definition, the range of feasible options, and the impacts of the options. Consultation can be inadequate for a number of reasons, including:

- when affected or interested parties are not consulted (eg, not consulted at all or unrepresentative consultation, such as where only large organisations are consulted), and
- when consultation processes are ineffective (eg, consulted parties not given enough time to respond, important issues not consulted on, consultation documents not promoted widely enough).

The magnitude of the proposal, including who is likely to be affected determines who and how to consult—more consultation is required if the proposal has wide-reaching impacts.

In most cases, and particularly for significant proposals, there should have been material consultation before the Regulatory Impact Assessment is drafted. The draft Regulatory Impact Assessment nevertheless provides another vital basis for consultation, both with affected parties and with government agencies. The Regulatory Impact Assessment format (which follows the Impact Analysis Framework) also provides a useful vehicle for providing advice to the portfolio Minister, during the course of policy development.

The draft Regulatory Impact Assessment should therefore be circulated for comment to relevant government agencies. Ideally, this should be done before the Cabinet paper is prepared. Otherwise it must be circulated with the draft Cabinet paper. It must also be included with draft Cabinet papers when they are submitted to Officials’ Committees.

Who to consult

In addition to consultation with affected parties, a number of government agencies may need to be consulted, depending on the nature of the option or proposal.

For guidance on which departments require consultation on particular issues, see this CabGuide section on consultation with government agencies⁵. It does not provide a complete list of consultation requirements, but is intended to assist officials in identifying the departments they should consult.

For regulatory proposals, key government agencies to consult (as well as the relevant Treasury policy team) include the following:

- The **Ministry of Justice** (MoJ) is responsible for vetting proposals for consistency with the New Zealand Bill of Rights Act 1990, MoJ must also be consulted on proposals that potentially create or alter criminal offences, sanctions, or penalties.
- The **Ministry of Foreign Affairs and Trade** (MFAT) has certain obligations with respect to ensuring New Zealand's compliance with international agreements to which we are a Party. It is therefore important to consult MFAT where a regulatory proposal could affect New Zealand's international obligations.

These obligations include the Agreements of the World Trade Organisation (WTO), Closer Economic Relations (CER), free trade agreements, etc. Where a proposed regulation affects, or may affect traded goods and services, or foreign investment, the advice of the Ministry should be sought on whether the proposed regulation is consistent with these obligations. Even where proposed regulation is consistent, there may be an obligation to notify an international organisation or a trading partner of the proposed measures and allow them to comment. The usual timeframe for comments is 60 days.

- The **Ministry of Business, Innovation and Employment** (MBIE) should be consulted on proposals that may impact on businesses, particularly those that impose compliance costs and direct costs. MBIE should also be consulted on regulatory proposals that have Trans-Tasman Mutual Recognition Agreement (TTMRA) implications.

The TTMRA is a horizontal arrangement that impacts on a wide range of non-specified areas and is predicated on a number of principles, including comprehensiveness (there should be limited exceptions) and mutual recognition principles (as opposed to *harmonisation* principles). Judgments need to be taken on a case by case basis taking into account both trans-Tasman and domestic factors. Judgments should also be informed by Cabinet's Impact Analysis Requirements (as required by the Council of Australian Government (COAG) Principles and Guidelines for National Standard Setting and Regulatory Action).

- For matters relating to **local government**, or potential regulatory options that may be implemented or enforced by local government agencies, please refer to the [Department of Internal Affairs' Guidelines](#) for which entities to engage with directly.

⁵ <http://cabguide.cabinetoffice.govt.nz/procedures/consultation>

2.7. Conclusions and recommendations

It is crucial for Impact Analysis, and particularly for the summary of the analysis in the Regulatory Impact Assessment, to clearly explain what decisions are required, what choices are available, and what stage of the policy process the Impact Analysis reflects. Failing to clearly articulate the difference between the status quo and the outcome that is being presented via the Cabinet recommendations (either the preferred option or any of the alternatives) will limit the transparency of the Impact Analysis.

There are various ways of summarising and presenting the outcomes of options analysis. Summary information to convey includes:

- For each option, a **summary of the main costs, benefits and risks** and overall (net) impacts, in relation to the status quo. This should include aggregates (eg, economy-wide totals).
- **Key assumptions underlying estimates of net benefits.** For example, the assumptions around expected compliance rates.

The usual methods of presenting convincing options analysis in a Regulatory Impact Assessment to meet Cabinet's Impact Analysis Requirements include:

- cost-benefit analysis (CBA) if feasible—an assessment of net-benefits including quantitatively, and if necessary qualitatively, estimated impacts (see Treasury's [Cost-Benefit Analysis Primer](#))
- cost-effectiveness analysis, if feasible—to determine the least cost method of achieving a policy objective or standard, and
- incentive analysis—if an option's design is intended to change the behaviour of certain groups.

Any conclusions regarding the impacts of different options should ideally be expressed in terms of net present values (NPVs) over a reasonable time-horizon. Any weighting of risks should also be made explicit. That is, it should be made clear how trade-offs have been made (eg, between a high-risk/low cost option, and a low-risk/high cost option).

The [OECD Introductory Handbook for Undertaking RIA](#) contains greater detail about these methods⁶. In each case, the aim is to compare the likely situation under the status quo with each option and conclude which option is preferred according to the objectives and a judgement about net-benefits. While there should be enough impact analysis to be able to compare options, a greater level of effort should go into analysing the impacts of the preferred option and the recommendation in the Cabinet paper (which may be different).

It is unlikely that a Regulatory Impact Assessment or discussion document can meet Cabinet's Impact Analysis Requirements if no clear methodology for assessing options has been explained, or if the analysis has not been articulated convincingly to inform decisions.

⁶ Available online at: <http://www.oecd.org/gov/regulatory-policy/44789472.pdf>

Presenting a summary of the options analysis

There are multiple ways of summarising the Impact Analysis in a Regulatory Impact Assessment and the presentation should be tailored to how the option has been described. For example, different parts of the problem and option may need to be described separately. A conclusion about the preferred option is not always required or possible, but the Regulatory Impact Assessment requires at least a brief, clear statement to summarise options and set out the evidence base on which a decision would rest on.

A simple table can be a useful way to organise the options, structure the summary of the options analysis, and describe the net-benefits (efficiency) alongside the options' ability to achieve the stated policy objectives (effectiveness). This is just one of many potential example tables for summarising the results of the Impact Analysis.

Options	Objectives	Impacts		Overall Assessment
	Are they met? How?	Net Effects	Risks	Preferred? Why?
Option 1	Describe	+/-	Describe	Describe
Option 2	Describe	+/-	Describe	Describe
Option 3	Describe	+/-	Describe	Describe

2.8. Implementation

Impact Analysis requires consideration of how the preferred option would be implemented if agreed. If the option being presented to Cabinet is different, the Impact Analysis should also include consideration of how that option could be implemented.

Choices around the implementation and enforcement of a regulatory option can have a major influence on expected compliance rates and whether the expected costs and benefits will materialise (ie, the likely effectiveness of the regulation). Significant costs can be incurred during the implementation stage (such as the costs of monitoring and data collection) so key parameters should be included in the analysis of the costs and benefits of options.

Impact Analysis should cover the entire implementation and enforcement stages of the policy by describing the impact of different choices around enforcement strategy on costs and benefits (expected compliance and effectiveness). Consideration should also be given as to how enforcement costs will be funded—although the appropriate level of analysis of implementation will depend on the stage of the policy development process and the magnitude of impact.

It is therefore important to consider some practical implementation issues before key policy and design choices are taken. To the extent that implementation design issues are not covered in the description and analysis of options and impacts, specific implementation considerations include:

- **Administration** issues, such as which agency will implement and administer the option and how it will function.
- **Timing and transitional arrangements** eg, delayed or gradual introduction of new requirements, provision of interim assistance.
- **Compliance costs minimisation strategies**. What implementation strategies will be required, such as an education campaign, the use of electronic technology, form design, advisory services and testing with stakeholders? Is there existing regulation that can be reduced or removed to prevent overlap?
- **Implementation risks** and their potential impact on the effectiveness of an option. Strategies for mitigating these risks should be explained.
- **Information** that regulated parties will require in order to comply with the regulation, and how this will be provided (eg, whether there is opportunity to rationalise or “piggyback” on existing information sources or methods of communication).
- **Enforcement strategy**—how compliance will be enforced, who will undertake this, whether there will be sanctions for non-compliance (eg, warnings, fines, licence suspension, prosecution, and whether there will be gradations of sanction depending on the level/severity of breach), the suitability of risk-based enforcement strategies.

Impact Analysis also needs to establish plans for oversight and operational safeguards. Who could (and who will) be best placed to make informed judgements about the operation of the regulatory regime, the enforcement of rules, and the performance of the regulator? These may not be the same groups, but all affected parties should be considered for their likely interest and exposure to regulator discretion and behaviour

The plans for how stakeholders are expected to continue engaging with agencies should also be clearly articulated so that stakeholders can have an indication of likely compliance costs. Imposing information and reporting requirements can create costs that are difficult to quantify without information from affected parties through consultation.

It is important that Agencies strike the right balance between collecting the necessary information to meet their responsibilities to the public, while not requiring information that is unnecessary or unavailable. Agencies and relevant regulators should only collect information essential for enforcing rules or monitoring regulatory objectives and behaviour. They should also ensure that processes are in place to only collect information once—not multiple times redundantly.

The Department of Internal Affairs (DIA) has published [Achieving Compliance - A Guide for Compliance Agencies in New Zealand](#) which contains more detail about implementing policies.

The importance of implementation

The prevailing view has been that the implementation of legislation is “something that regulators do”, once the law is passed. This view is changing, as we increasingly recognise that how regulation works in practice has as much to do with factors that influence implementation as the law itself, and these factors can and should be taken into account in the policy development process and regulatory impact analysis.

There are two distinct phases to implementation:

- the initial phase when a new law is introduced, and
- the ongoing administration and review of the law.

The initial phase has distinct characteristics as it is at this point that historical behaviours are required to change in line with the expectations underlying the law. Behaviours are a function of both attitudes and capabilities. In addition, it is often the case that the behaviours of more than one group need to change. Experience suggests that the behaviours that must change to achieve the objectives of the law are often path-dependent and can be deeply embedded, and we typically under-estimate the effort required to effect change. Therefore, we need to allow sufficient time for implementation, to adopt appropriate strategies to facilitate and manage the change process, and undertake sufficient ongoing monitoring and evaluation.

The questions that should be asked at the outset include:

- What groups will be affected by this law (this will bear on the analysis of the status quo; key groups include producers, consumers, regulators, standards bodies etc)?
- What behaviours would we expect these groups to demonstrate if the law is to achieve its intended objectives? Bear in mind that actors respond to their “complete” regulatory environment, which may involve other areas of regulation and legislation than the policy question at hand.
- What might act as a barrier to behavioural change? Put yourself in the shoes of the affected parties – what incentives are in place to influence their behaviours?
- What strategies are likely to work best during the implementation phase to reduce these barriers? This will include consideration of appropriate transition arrangements.

- What monitoring and evaluation strategy is required to identify and address emerging issues that are affecting the effective implementation of the law?

When considering the factors that influence the administration of the law on an ongoing basis, it is important to note that interventions that do not deliver on their intended objectives may reflect poor strategy choice by the regulator rather than the rules themselves. There are two key factors to consider in the analysis:

- 1 Regulators are always in the situation of allocating limited resources. In effect they must make hard choices about where to invest their regulatory capability. Risk-based frameworks are most commonly used today to make resource allocation decisions. In effect these require regulators to make an assessment of the likelihood and consequences of certain adverse events happening, relative to the cost of mitigating them, and use this information to prioritise activity. Dealing with uncertainty is an important dimension of risk-based regulatory action.
- 2 Regulated entities are not homogenous. A strategy that works best for one group may not be effective or necessary for another.

Given these two factors, in addition to revisiting the factors and question outlined above, the questions we should also ask at the outset include:

- Does the proposed law permit risk-based decision making by the regulator?
- Can we be assured that the regulator will take a risk-based approach?
- Does the regulator have the statutory tools to take a “fit for purpose” approach to enforcement?
- Can we be assured that the regulator will take a “fit for purpose” approach?

INTERIM VERSION

2.9. Monitoring, evaluation and review

Impact Analysis must establish the agency's plans for monitoring, evaluating, and reviewing the performance over time. The key questions are:

- How will the Agency determine when and whether the regulatory changes have performed well?
- How will the Agency assess whether the preferred option continues to have a greater net-benefit than alternatives?

While the plans for monitoring the implementation of the preferred option should be summarised in the Regulatory Impact Assessment, it is also important that any new regulation is monitored and periodically reviewed to evaluate whether the option is the preferred solution to the particular policy problem over time. Such monitoring and evaluation helps to ensure that new regulations are working as expected (delivering the anticipated benefits at expected costs), that there have been no unforeseen consequences and they continue to be necessary as circumstances change and evolve.

When new regulatory options are being proposed, it is important to have a clear understanding of the channels through which the intervention is expected to generate the intended benefits. Analysis needs to consider how effectiveness will be measured: what indicators will be used; what data will be required; how this information will be collected, and by whom. As noted above, monitoring and evaluation involves costs, which should be factored in to the analysis of options.

On-going or periodic consultation with stakeholders may be appropriate, in which case the arrangements for this should be agreed. It may be appropriate to establish a feedback mechanism (eg, a way for stakeholders to ask questions or lodge complaints). Regular, public reporting on the effectiveness of the regulation may also be considered.

Plans should also be made for how and when the regulation will be reviewed. Agencies should consider committing to a periodic review of particular regulatory interventions, either through a sunset-review clause in the regulation itself, or through committing to collect and monitor information for evaluating regulatory performance. Reviews should be reported and consulted on with a view to ensuring regulation remains fit for purpose.

Reviews should consider the following issues:

- Is there still a problem (and is it the one originally identified)?
- Are the objectives being met?
- Are the impacts as expected? Are there any unforeseen problems? Are there any indirect effects that were not anticipated?

Is intervention still required? Is the current intervention still the most appropriate, or would another measure be more suitable?