



SIGMA Papers No. 31

Improving Policy  
Instruments through Impact  
Assessment

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**IMPROVING POLICY INSTRUMENTS THROUGH IMPACT ASSESSMENT**

**SIGMA PAPER: No. 31**

Unclassified

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## THE SIGMA PROGRAMME

SIGMA — Support for Improvement in Governance and Management in Central and Eastern European Countries — is a joint initiative of the OECD and the European Union. The initiative supports public administration reform efforts in thirteen countries in transition, and is principally financed by the European Union's Phare Programme.

The Organisation for Economic Co-operation and Development is an intergovernmental organisation of 30 democracies with advanced market economies. Its Centre for Co-operation with Non-Members channels the Organisation's advice and assistance over a wide range of economic issues to reforming countries in Central and Eastern Europe and the former Soviet Union. Phare provides grant financing to support its partner countries in Central and Eastern Europe to the stage where they are ready to assume the obligations of membership of the European Union.

Phare and SIGMA serve the same countries: Albania, Bosnia-Herzegovina, Bulgaria, the Czech Republic, Estonia, the former Yugoslav Republic of Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Established in 1992, SIGMA works within the OECD's Public Management Directorate, which provides information and expert analysis on public management to policy-makers and facilitates contact and exchange of experience amongst public sector managers. SIGMA offers beneficiary countries access to a network of experienced public administrators, comparative information, and technical knowledge connected with the Public Management Directorate.

SIGMA aims to:

- assist beneficiary countries in their search for good governance to improve administrative efficiency and promote adherence of public sector staff to democratic values, ethics and respect of the rule of law;
- help build up indigenous capacities at the central governmental level to face the challenges of internationalisation and of European Union integration plans; and
- support initiatives of the European Union and other donors to assist beneficiary countries in public administration reform and contribute to co-ordination of donor activities.

Throughout its work, the initiative places a high priority on facilitating co-operation among governments. This practice includes providing logistical support to the formation of networks of public administration practitioners in Central and Eastern Europe, and between these practitioners and their counterparts in other democracies.

SIGMA works in five technical areas: Public Administration Development Strategies; Policy-Making, Co-ordination and Regulation; Budgeting and Resource Allocation; Public Service Management; and Audit and Financial Control. In addition, an Information Services Unit disseminates published and on-line materials on public management topics.

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## FOREWORD

Central and eastern European countries have been and still are adapting their legal framework to the requirements of a Western market economy and the body of EU legislation, the *acquis communautaire*. As the harmonisation of the national legal framework to EU standards is one of the yardsticks for EU accession, most candidate countries have drafted and adopted new legislation under enormous time pressure. Sub-optimal solutions, unforeseen implementation costs and unintended side effects were unavoidable. In many cases new legislation has proved impossible to implement. This experience has led candidate countries and other transition countries to develop an interest in impact assessment.

EU Member States introduced impact assessment for legal programmes about two decades ago, based on the experience that new legislation may have a considerable and sometimes unexpected, impact not only on the budget, but also on various parts of the economy and society as a whole. Today, there is an acceptance among EU Member States that some kind of impact assessment exercise should be conducted before legislative changes are introduced.

Although the comprehensiveness of a particular impact assessment exercise depends on a variety of factors, e.g. the importance of the policy issue or the commitment of the respective government, the basic aim is to enhance the quality of government decision-making. Establishing or improving the administrative capacity to carry out impact assessments is crucial for both in order to provide the government with the necessary information to take informed decisions on policy options and to improve the quality of new legislation. Even applying only the basic principles of impact assessment can often avoid the necessity for immediate amendments or redrafting.

This publication deals with impact assessment in a wide sense, including policy analysis (impact assessment for choosing the instrument), assessment of a policy instrument during the drafting stage and evaluation of existing laws or programmes. Special emphasis is given to impact assessment during drafting.

The content of this publication is based to a large extent on the considerable work carried out in this area by the Public Management Service (PUMA) of the OECD and by a large number of EU and OECD Member States. For example, Chapter 1 draws *inter alia* on a guideline developed for the German Federal Ministry of the Interior and the Ministry of the Interior of Baden-Württemberg by the Verwaltungshochschule Speyer. The publication also draws on previous work carried out by SIGMA in the field of law drafting and impact assessment.

The target audience is primarily ministries in Central and Eastern Europe, but the publication could also prove useful to other transition countries that are in the process of improving their legal framework.

Several authors have contributed to this publication. The contributors are listed here in alphabetical order: Michal Ben-Gera, Brian Finn, Anke Freibert, Simon James and Alan Mayhew.

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All SIGMA Publications are available on the SIGMA website or from the address below.

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## EXECUTIVE SUMMARY

Under pressure to bring their regulatory systems into line with the *acquis communautaire*, while addressing many other problems, CEE governments run the risk of introducing sub-optimal laws and regulations.

This can mean that legal norms:

- cannot be implemented because institutional capacities are not up to the task, or sufficient budget funds are not available;
- impose unnecessary costs on society or the economy leading to loss of competitiveness;
- are not judicable because of the quality of legal drafting or the capacity of the justice system;
- open up opportunities for abuse and corruption;
- introduce bias in favour of certain actors;
- or simply do not achieve their goals.

How can such dangers be avoided? In many countries of the Union, policy capacities have been improved to reduce risks. One of the steps taken was to introduce impact assessment and to embed it in the institutional setting where policies are developed and laws and regulations are drafted. A new system aiming at simplifying the regulatory environment in the Union is currently being introduced at the European Commission.

Impact assessment is designed to improve the quality of information available to decision-makers. Clearly, political decisions are influenced by more than “professional” information. However, it is important that politicians fully understand the consequences, e.g. the costs, benefits and distributional effects of their decisions. That is the contribution of impact assessment.

Typically, decisions made in the “policy cycle” are:

- identification of the best way of tackling a problem (choice of the appropriate policy instrument);
- design of the instrument;
- evaluation of the performance of the instrument.

In each phase of the policy cycle Impact Assessment provides information to help make better decisions.

The cost of a bad law to the economy and the budget is usually far greater than the cost of a few trained staff to carry out a proper assessment of legal projects. This publication is a guide for technical staff on impact assessment. But, unless Ministers are supportive of the work, techniques will not improve the situation.

***The urgent message of this paper is that ministers should encourage the use of impact assessment by writing it into governmental decision procedures, providing resources and demanding quality information from their staffs before taking decisions.***

The publication comprises four chapters, an annex and a bibliography.

The first chapter offers a general overview on impact assessment in the different stages of the development of policy instruments. It presents the rationale, the objectives and the main issues to consider in order to obtain a comprehensive view of the possible impacts of the policy instrument. It includes the "ten best practices" identified by the OECD and the regulatory quality checklist which is included in the Recommendation on Improving the Quality of Government Regulations, adopted by the OECD Council in 1995.

The second chapter deals specifically with the assessment of budgetary and overall economic impacts, as these are clearly of predominant concern for central and eastern European countries. Besides the methodology, it offers some information about the techniques used.

The third chapter discusses consultation as a means to ease and improve impact assessment. It is not intended to cover consultation comprehensively, e.g. as a means to increase transparency or acceptance.

Finally, the fourth chapter is devoted to the use of impact assessment in the accession process. As accession to the European Union is a predominant topic in central and eastern European countries, it seemed adequate to point out how impact assessment could improve this process and how it could be used after becoming a Member.

The annex includes an example of a guideline on impact assessment, taken from the General Working Rules of the Government of the Palatinate, Germany. The bibliography contains references, useful guidelines and some related Internet links.

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## 1. IMPROVING POLICY INSTRUMENTS THROUGH IMPACT ASSESSMENT

### 1.1. Introduction

The countries in Central and Eastern Europe have been and still are undergoing a significant overhaul of their existing structures, systems and legal frameworks. Whatever the task, be it adapting to a market economy, updating social security and health systems, or preparing for EU enlargement, governments and their administrations must further develop their policy capacities and attempt to ensure that laws and programmes meet the needs of society and are effectively and efficiently designed and implemented.

In developing their policy capacity, the countries of Central and Eastern Europe face the challenge that improvements are still needed in all phases of the policy cycle: defining policy objectives; development of policy options; elaboration of the policy instrument; implementation and evaluation. Impact assessment is an important tool for improving policy capacity and thereby improving the quality of political decision-making and policy instruments.

There are three phases in the policy cycle where impact assessment is particularly useful:

- In the policy development phase. Once the political decision has been taken to pursue certain objectives and goals, impact assessment is used to develop policy options and to select the most appropriate policy instrument to achieve the objective.
- In the instrument development phase. Once the instrument has been chosen, impact assessment is used while drafting the instrument, to ensure that it is well-designed and will meet the given objectives in an efficient and cost-effective manner.
- In the evaluation phase (*ex post* evaluation). Once the instrument has been implemented for a certain time, impact assessment is used to verify the real impact; assess to which extent the objective has been met and initiate amendments/corrections, if necessary.

The focus of this chapter is on impact assessment in the instrument development phase, though some consideration is given to the development of policy options and to *ex post* evaluation.

Policy instruments have been defined as mechanisms to induce desired change. There are basically three types of policy instruments:

- regulatory instruments: including rules, prohibitions, licences, etc.;
- financial instruments: including subsidies, taxes and tax deductions, user fees, certain types of budgetary expenditure;
- informational instruments: including advertising campaigns, information booklets, or use of the Internet.

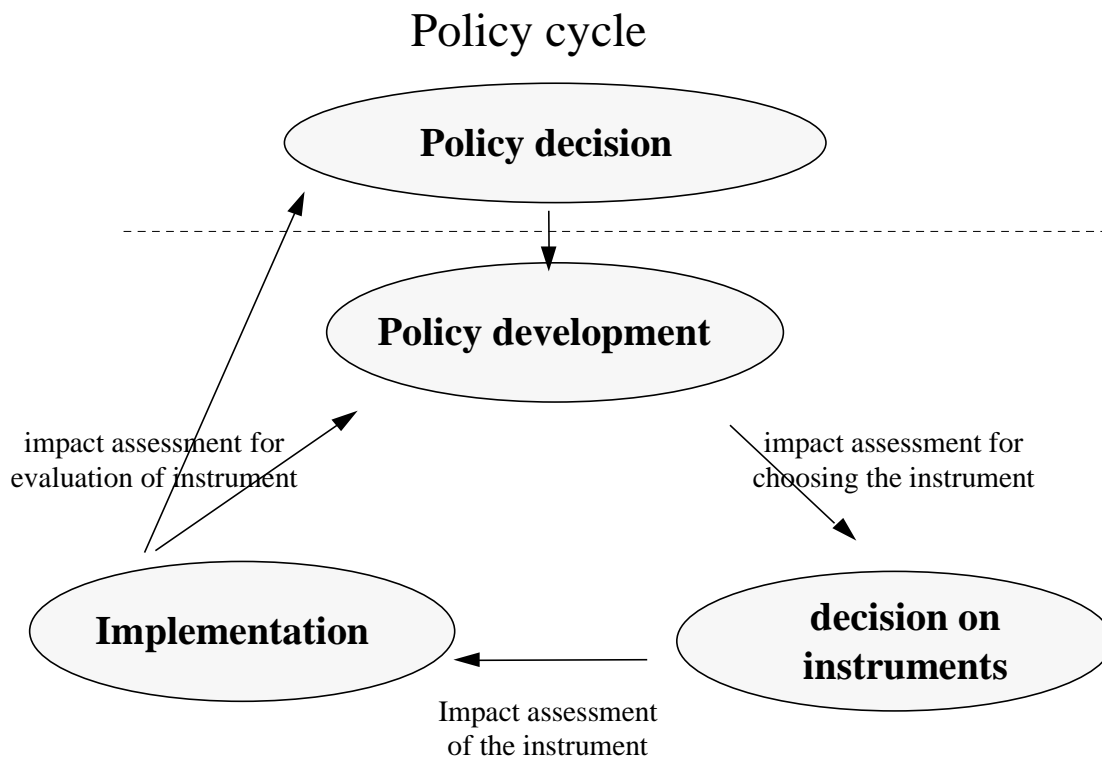
The predominance of the continental European administrative model in central and eastern European countries means that nearly all policy instruments, even informational, require a legal base such as a law or

regulation in order to be implemented. For this reason, the paper focuses on impact assessment in the context of legal instruments.

Self-regulation by markets, sometimes seen as a non-legal instrument, may not yet be a very common policy instrument in central and eastern European countries. In addition, given the legal tradition, self-regulation by markets may, in any event, call for legal instruments to be implemented (e.g. a regulation would normally be required to inform consumers about the content or the origin of food products and thus give them a more informed choice).

It should be stressed that also in those cases where a policy objective is pursued without a specific legal instrument, the policy instrument can and should be assessed in the same way. For instance, although this publication refers only to a very limited degree to impact assessment with regard to investment programmes, such as industrial parks, highways, dams etc., the procedures, methods and techniques referred to, can and should be, applied to such programmes.

As stated above, impact assessment should follow the policy cycle. A schematic view of the policy cycle is presented below. Alongside the arrows connecting the policy phases are shown the types of impact assessment that should be carried out in relation to that phase.



## 1.2. Why Impact Assessment

Impact assessment is a tool to improve the information base at each stage of the policy cycle, which in turn allows for better-informed decision-making at the political level.

Since impact assessment provides information about the possible consequences of new policy instruments or real consequences of existing instruments, it contributes to reforming and modernising the state. It is also a valuable tool for regulatory management, i.e. the management of the legal framework of a country. The objective of impact assessment is twofold:

- to improve the policy instruments themselves; and
- to reduce the number of legal instruments by avoiding unnecessary legislation.

Good impact assessment should help to produce fewer, clearer and more acceptable pieces of legislation.

Carrying out impact assessment is only useful if it has a real influence on decisions to be taken. Impact assessment is an aid for decision-making but not a substitute for it. It does not replace political decisions, nor the political responsibility of the Minister or the council of ministers. The results of impact assessment should be seriously considered when taking political decisions. However, there are other important factors influencing political decisions, which in some cases may be more important to the government than the results of analysis and assessment. These are factors such as electoral commitments, coalition agreements, bias for a certain electorate, subjective judgements of politicians, and various external and government-internal pressures. Nevertheless, it remains the responsibility of civil servants to carry out good assessment, and to present the results to Ministers in the most objective way possible, while recognising that the final decision rests with Ministers.

### **1.3. What is Impact Assessment**

Impact assessment is an information-based analytical approach to assess probable costs, consequences, and side effects of planned policy instruments (laws, regulations, etc.). It can also be used to evaluate the real costs and consequences of policy instruments after they have been implemented. In either case, the results are used to improve the quality of policy decisions and policy instruments, such as laws, regulations, investment programmes and public investments. Basically, it is a means to inform government choices: choices about policy instruments, about the design of a specific instrument, or about the need to change or discontinue an existing instrument.

Some form of impact assessment should always be carried out if the envisaged policy change is expected to give rise to significant changes and/or costs, e.g. new tax laws, labour code, social security laws, or subsidies regulation. To produce useful results, it is important for impact assessment to consider probable future developments and to assess the impact under different assumptions, e.g. different scenarios regarding economic developments, EU Integration, etc.

Impact assessment offers:

- comparative information on foreseeable consequences of the different policy alternatives available to solve a given policy problem or to meet a given policy objective;
- during the drafting of the instrument, information on issues, such as compliance, implementability, specific burdens and/or advantages for certain groups of society;
- for an existing instrument, information on the degree to which it has met the intended objectives and on the degree to which it has been implemented by the administration and accepted by the public.

As already pointed out, impact assessment can and - if possible - should be applied several times during the policy cycle in order to improve the quality of policy instruments, i.e. laws, regulations, and investment

programmes over the long term. Depending on the point in the policy cycle when a particular impact assessment exercise is being conducted, i.e. as a forecasting or evaluation instrument, the importance of certain techniques used for the assessment may vary.

#### **1.4. How to Carry out Impact Assessment**

The time and resources to be put into impact assessment should depend on the importance of the policy instrument. The more important the policy instrument is and the more impact it can be expected to have, the more sophisticated the impact assessment should become. A thorough impact assessment is neither easily nor rapidly carried out. In fact, it calls for professional expertise, time and resources. An impact assessment for a less important policy instrument can be carried out by civil servants, even if they do not have in-depth training in quantitative and qualitative assessment techniques.

Some limited impact assessment should be undertaken for all intended policy decisions. In most cases, impact assessments do not have to be very large-scale or call for sophisticated research or a large amount of statistical data. Ways to do a modest impact assessment with — in general — significant results, are:

- inter-ministerial meetings to discuss potential consequences;
- consultations with all interested parties;
- evaluation of existing research;
- testing the legal instrument by applying it to a few real cases;
- a disciplined review of potential consequences, such as possible cost factors, where these costs may arise and which possible unwanted side effects may occur;
- limited cost-benefit and/or cost-efficiency analysis.

A thorough impact assessment should be carried out for important new policies/policy instruments/legislation. For example, building a new airport or undertaking a thorough reform of the tax or social security system should only be undertaken after a thorough impact assessment. This assessment could include — in addition to a normal impact assessment — the following, for example:

In addition to consultations, which should always take place, typical methods and techniques to carry out an assessment of a draft instrument are:

- cost-benefit analysis;
- cost-efficiency analysis;
- technical advice from outside the administration;
- simulations;
- testing of the instrument by applying it to real cases on a pilot basis.

The long-term effects of such reforms are generally well worth the investment in a thorough impact assessment.

Impact assessment is often equated with cost-benefit and cost-effectiveness analyses. Certainly, these analyses form an important, if not the most important component of impact assessments. Details on carrying out such analyses are included in Chapter 2 of this paper. Even if a full cost benefit analysis cannot be carried out, due to lack of data or capacity, it remains necessary to try to estimate all costs

(budgetary, economic, social, and environmental) which may arise and to identify and list all the benefits that can be expected. For smaller instruments a rather reliable estimation of costs and benefits can be achieved through inter-ministerial meetings and consultations with outside experts and groups.

## **1.5. How to Ensure Impact Assessment**

Impact assessment of draft policy instruments has been mandatory in all EU Member States for quite some time. This requirement is usually laid out in the general working rules of the government. These working rules may offer a checklist with questions and/or guidelines on how to carry out impact assessment. It is normally stipulated in such rules that no proposal for a decision shall be submitted to the council of ministers unless accompanied by a paper that shows the need for the decision and documents the results of the impact assessment. That this requirement exists in EU Member States does not necessarily imply that it is always met in a very professional and thorough way. However, over the years the value of impact assessment for the improvement of the legal framework has become more and more recognised and in turn the political decision-makers and parliaments increasingly insist on impact assessment as a basis for an informed policy decision.

## **1.6. How to Use Impact Assessment in the Policy Cycle**

This section describes in some detail how impact assessment should be carried out in each phase of the policy cycle. Since the focus of this chapter is on the second phase — impact assessment of a draft instrument — it is discussed first and in greater detail. However, much of what is said about this phase can also be applied to the other two phases.

### ***1.6.1. Impact Assessment of a Draft Instrument***

When drafting a legal instrument, impact assessment is used to optimise the efficiency and effectiveness of the instrument in order to ensure that to the extent possible, it will achieve the intended objectives at minimum cost and with the least number of unintended negative consequences. The assessment is carried out by testing the draft (or parts of it) against a set of pre-defined assessment criteria such as practicability, costs, implementability, clarity and expected compliance.

The expected results of impact assessment at this stage will be information on:

- budgetary, social, economic, environmental costs and benefits;
- possible problems with enforcement, acceptance and compliance;
- distribution of the costs and benefits within the population and sub-groups;
- possible flaws, contradictions, lack of clarity, and gaps in the draft; and
- unwanted side effects.

The results of such impact assessment provide the basis for introducing changes that can reduce costs, improve benefits, and minimise unwanted and unexpected consequences of the instrument.

To yield these results, an impact assessment should be divided into three distinct steps:

- preparation;

- analysis;
- assessment of the results of the analysis.

Only thorough preparation will enable the lead administration to carry out an efficient analysis and, when assessing the results of the analysis, produce feasible recommendations for change. In order to clarify the work that will need to be carried out during the three steps of an impact assessment an indication is given below:

#### *Preparation*

Preparation of the assessment must start with the determination of the specific objectives and expected results of the assessment. Expected results could be information on cost, implementability or enforcement possibilities. The expected results then have to be broken down and defined as detailed assessment criteria (see below at the end of 1.5.1), against which the assessment will be carried out.

After the decision on criteria and scope of the assessment has been taken, the methods and techniques to be applied in the assessment have to be determined.

Finally, to apply the selected methods and techniques to the instrument, further preparation is necessary. Possible diverging future developments in the policy area (scenarios) have to be sketched out, in order to assess the draft instrument under different possible conditions.

For a cost-benefit or a cost-efficiency analysis, relevant statistics on the existing situation in the policy field must be gathered. For a simulation, theoretical cases, incidents and scenarios have to be developed against which the draft law can be tested. For a test with real cases, such cases or a region will have to be selected where the draft will be applied on a pilot basis, in parallel to the existing legislation.

The costs for the different methods and techniques vary considerably. To carry out a test of the instrument by applying it on a pilot basis to real cases, takes time and a considerable amount of resources. Preparing cases, incidents, and scenarios for a comprehensive simulation can be costly, especially if they have to be prepared by experts outside the administration. The cost and effort of testing the instrument will have to be weighed against the importance and the probable improvement of the instrument.

#### *Analysis*

Only after thorough preparation, should the different methods and techniques be applied, as only then can they yield the best possible results. If it has been decided to carry out an in-depth impact assessment, it is usually necessary to involve outside expertise in the analysis of the instrument.

Detailed information on how to carry out a cost-benefit analysis, cost-efficiency analysis and consultation as methods for the analysis are given in Chapters 2 and 3. Pilot tests and simulations should, if at all possible, always involve those most affected by the instrument. This includes those civil servants who will have to administer or manage the instrument, as well as the citizens and enterprises who may benefit from, or be constrained by, the instrument. These people are usually sensitive to possible problems with the draft, in particular regarding implementability (e.g. getting a clear understanding of tasks and responsibilities, and enforcement issues) and costs (e.g. necessary additional investments, specific administrative burdens for enterprises). The information they might provide is therefore invaluable for the quality of the assessment.

### *Assessment of the Results of the Analysis*

The results of the analysis have to be systematically documented and evaluated. The outputs of this phase are a report on the assessment and recommendations. The recommendation of the impact assessment of the draft instrument might be:

- to keep the draft instrument as proposed;
- to introduce specific changes or amendments to the draft before submitting it to the Minister;
- to cancel the draft, or to pursue a completely different approach.

When any possible changes or amendments have been introduced into the draft, it can then be submitted to the Minister of the lead ministry for approval. The report of the impact assessment and the recommendations should be submitted, together with the draft instrument itself. If particular recommendations have been rejected, this should be indicated and reasons given.

After the approval of the Minister, who may initiate additional changes, the draft, with the report and recommendations, can be submitted to the council of ministers for decision.

### *Assessment Criteria*

As already pointed out, there are several other important issues besides costs which should be considered when undertaking an impact assessment.

The issues, which should always be included in the list of criteria against which the draft instrument is assessed, are listed and briefly explained below. A specific cost aspect is also included (for a more comprehensive description see Chapter 2).

These criteria are of particular importance when assessing a draft legal instrument; for this reason they are listed in this section. However, they are also valuable criteria for other forms of impact assessment as well as for assessing investment programmes or other government decisions.

Depending on the time and resources available, the draft should be assessed against the following criteria in a more or less thorough manner.

### *Meeting the Objective*

This criterion is geared to assess whether or not the draft instrument meets the set objective to the best possible degree. For the analysis it is necessary to explore the following questions:

- Could there be counterproductive side effects?
- Is it possible/easy to avoid compliance?
- Is misuse of the instrument possible?
- Are short-term costs justified by the long-term benefit (e.g. preventive health measures or environmental provisions)?
- Is the distribution of benefits and costs justifiable and in line with the given objective?
- Is there a significant discrepancy between the segment of the population that pays the price, and the segment that gets the benefits?

**Example:**

*Reduction in Road Accidents*

The instrument to be assessed intends to enforce speed limits and to increase fines for traffic violations. When analysing this provision against the criterion "meeting the objective" the following questions have to be considered:

- Are the accidents really due to speeding?
- Is there a high probability that road accidents are reduced when introducing a speed limit and higher fines for traffic violations?
- Will speed limits lead to traffic jams and higher pollution?
- Can drivers easily avoid complying with speed limits?
- Will the investment in new staff for the police forces, necessary to enforce the speed limits, be justified by the reduction in road accidents?
- Which group in society will pay the fines — only those who have no warning devices?
- Do the taxpayers who contribute to investment in the police forces also benefit from higher security on the roads?

*Practicability*

This criterion is used to assess if the draft instrument can be effectively applied in the existing administrative structure. For the analysis, it is necessary to explore *inter alia* the following questions:

- Is the instrument sufficiently flexible to accommodate all possible cases but still offers enough guidance so that discretionary provisions cannot lead to arbitrary decisions?
- Are administrative requirements limited to the degree necessary? Is it probable that the cost for administering the instrument outweighs the benefit (e.g. fees for administrative services)?
- Are the competencies for executing the instrument including the requirement of co-ordination clearly defined?
- Is the transition from the old regulation to the new instrument clearly laid out and feasible?

**Example:**

*Objective: Speed up administrative decisions in awarding construction permits:*

The instrument to be assessed is intended to distribute responsibility for issuing construction permits amongst different levels of administrative bodies, depending on the importance of the construction project. In addition, it envisages introducing a positive "silence" procedure (meaning that if the administration has not reacted within a given time frame to a request, the request is deemed to be accepted) for minor construction projects.

When analysing these provisions against the criterion "practicability", the following questions have to be considered:

- Are the definitions of minor and major construction projects clear enough so that the administration and the citizen can easily identify which administrative level is in charge?



- Are discretionary provisions regarding the limits of responsibility of the different administrative levels clear, or could they lead to arbitrary decisions?
- Are exceptions for specific cases, e.g. dangerous minor constructions, clearly defined?
- Are the procedures simple enough to really speed up the decision-taking?
- Are there so many exceptions that in fact the "silence" procedure is the exception and that therefore the new regulation is not practicable?

### *Clarity*

This criterion is geared to assess another aspect of implementability, i.e. possible difficulties for the private sector to understand the instrument correctly and to comply with it in an appropriate way. For the analysis it is necessary to explore the following questions:

- Is the language of the provision clear and understandable for the addressees?
- Are there any contradictions in the instrument?
- Are all definitions unambiguous?
- Are the tasks to be carried out by the addressees clearly listed, etc.?

### ***Example:***

*Objective: Speed up administrative decisions in awarding construction permits:*

The new law is targeted to engineers, architects and, for smaller construction projects, to all citizens. When analysing the provision against the criterion "clarity" the following questions should be considered:

- Is the language adapted to the target group in the best possible way?
- Are the cross-references within the law and to other laws kept to the necessary minimum?
- Are all provisions regarding the issuing of a construction permit in the same legal text?
- Is it clear to the citizen which papers he has to submit in order to obtain a construction permit, etc.?

### *Implementation Costs*

This criterion is geared to assess the costs and possible savings, directly linked to the implementation of the instrument. For the analysis, it is necessary to explore as a first step, where the costs will be incurred (administration, industry, and social groups) and then for the respective groups to explore the following questions:

- Are the incurred costs proportional to the intended objectives of the instrument?
- Are there possible savings which could set off partially/fully the costs incurred by the proposed instrument?
- Is the administrative work, including that asked of the addressee, (e.g. statistics, application forms, credentials, controls) proportional to the expected benefits?
- Are the envisaged institutional set-up and the envisaged procedures efficient or could costs be saved if organised differently?

***Example***

*Objective: Create new jobs to fight unemployment*

The instrument to be assessed is intended to offer subsidies to small and medium enterprises, on the condition they recruit young long-term unemployed school leavers.

When analysing this provision against the criterion "implementation costs" the following questions have to be considered:

- Is the application procedure easy enough not to discourage SME's?
- Is the amount of paperwork reasonable in relation to the subsidy they can expect?
- How much time will it take small and medium enterprises to collect all the necessary credentials?
- Are all the credentials really necessary?
- If reports are requested, can they be written easily?
- Does anyone really read the reports?
- Are reports and other administrative burdens created without envisaging any follow-up action or consequences if these tasks are not performed?

***Interdependencies***

The criterion is geared to assess whether or not the new instrument creates conflicting interdependencies with other legislation which may lead to unwanted side effects, e.g. non-targeted addressees are benefiting from or suffering from the new instrument. For the analysis, it is necessary to explore the following questions:

- Is there an existing legislation which covers the same or complementary target groups?
- Could there be an overlap with existing legislation which may hinder the implementation of the new instrument?
- Could provisions in existing legislation hinder or be in opposition to the intended objectives of the new instrument?

***Example:***

*Objective: Facilitate the creation of small/family enterprises*

The proposed law envisages allowing small/ family enterprises to employ family members without having to declare possible salaries and transferring the due income tax and social security contributions.

When analysing this provision against the criterion "interdependencies" the following questions have to be considered:

- Will exemption of family members lead to an even higher, possibly unjustified taxation of the owner of the enterprise?
- Is the loss of unemployment benefits for family members, due to non-contribution, justified?

- Could this provision lead to increased costs for public health care or social assistance?
- Should there be provisions and if so, which ones, to avoid an undue increase in the number of persons relying on public assistance due to non-contribution to a respective insurance scheme?

### ***1.6.2. Impact Assessment Aimed at Choosing a Policy Instrument***

Impact assessment for the choice of a policy instrument is used to explore the necessity of a legal intervention, to identify alternative policy options and their probable impact, to compare the options with regard to impact and feasibility and to determine the best possible policy option (one policy option may include several policy instruments).

The expected result of this impact assessment is a report that:

- describes and assesses the foreseeable consequences of the different policy options;
- identifies the probable setbacks and advantages of each option and justifies why one policy will most likely be the best option to reach the intended objectives.

In addition, the report will sketch out the intended draft legal instrument.

The three steps for this type of impact assessment are:

#### *Preparation*

After the political decision has been taken to carry out an impact assessment with the objective to explore possible government intervention in a given policy area, it is the task of the civil servants in the lead ministry to prepare the ground work.

It is the civil servants who are responsible for adequately examining the problem and for breaking down the overall policy objective into operational goals. Different policy options have to be developed and the criteria, which the policy option should meet, have to be determined (e.g. cost neutrality, advantages for a specific target group).

As a point of principle, the "zero option" always has to be considered and explored seriously. A zero option means that no government intervention is needed. The reason for the zero option could be that either government intervention would not solve the problem, or that proper enforcement of the already existing instruments could solve the problem.

In order to achieve more or less reliable results, it is advisable to consider possible future developments in the policy area and to assess the policy options by taking into account these future developments, i.e. by applying the options to different scenarios.

While preparing the policy options, a first consultation should take place. Consultations should be carried out with all the other concerned ministries and, if appropriate, with local authorities, with respective NGO's, other interested parties and with independent experts. This consultation round serves to gather as much information as possible in the area in which the government wants to intervene and to enable civil servants to develop sound policy options.

### *Analysis of the Possible Impact of the Different Policy Options*

As a second step in the assessment process, the different policy options have to be analysed and compared with regard to substance, internal logic, completeness. In addition, possible impacts of the policy options have to be analysed against quantitative and qualitative criteria. Again, it is the civil servants in charge of developing the policy instrument who are responsible for the quality of this analysis. To obtain the best possible results, it is necessary to discuss the policy options with all ministries concerned, the administrative bodies and the local authorities, as they may have to implement the policy option under consideration. If the project is of a certain importance, it is advisable to consult with the addressees (NGO's) and independent experts. It is important to ensure that the invited experts are from different professional backgrounds to avoid, as much as possible, biased information. The discussion/consultation may be in writing or could be carried out in the form of a public hearing or a workshop.

### *Assessment of the Policy Options*

As a final step, the results of consultations inside and outside the administration, as well as the results of the analysis carried out by civil servants in the lead ministry are evaluated, documented and comparatively assessed. The output of this comparative assessment will be a recommendation for the political decision-takers determining the policy option, which seems to best meet the set requirements.

The final decision on which alternative to pursue rests with the political level. There may well be political considerations which could result in choosing another rather than the recommended alternative.

### **1.6.3. *Impact Assessment for Evaluation of an Existing Legal Instrument***

An evaluation of existing laws or implemented investments is carried out to explore whether:

- the intended objectives were met in an efficient way;
- unwanted side effects occurred and to what degree;
- the instrument has proven to be easily implementable;
- a high degree of compliance has been reached; and
- benefits and costs were distributed in a justifiable manner.

The expected result of an evaluation would be information on the possible need for amendments, or even the abolition of the legal instrument. Concerning investments, the expected result could be whether or not further investments of the same kind would be useful, or if additional complementary investments are needed to optimise the return of the first investment.

The three steps of an evaluation are:

#### *Preparation*

During the preparation of an evaluation, it must be decided whether the whole, or only parts of the instrument are to be evaluated, if the scope of the evaluation has not already been decided by the government or the parliament when the instrument was originally enforced. In addition, the evaluation criteria have to be determined. Evaluation criteria could include the following: the degree to which objectives were met, cost development, cost-benefit effects, implementability and positive or negative side effects.

Evaluation is carried out by comparing the expected and intended impacts with the real impacts. To this end, the expected impact of the instrument has to be clarified and documented during the preparation of the evaluation. If a policy analysis or an assessment of the draft instrument has been carried out, the expected impact of the instrument can be drawn from that documentation.

#### *Analysing the Real Data against the Intended Impact of the Instrument*

The analysis begins with the collection of data on the real impact of the instrument. This information is then compared with the impact intended when the instrument was originally prepared. The real data should also, if at all possible, be compared with data collected before the new instrument was enforced. The latter is necessary to obtain information on what kind of change, if any, the new instrument actually brought about.

To obtain the necessary data it may be possible to use statistics. In addition, reports may be requested from executing administrations and addressees should be consulted, especially if statistical data is not readily available.

#### *Evaluation of the Instrument*

The collected information is evaluated in a comparative way. The evaluation criteria and the final evaluation of the instrument have to be documented. The recommendations, based on the evaluation, must be motivated in order to provide the political level with the necessary information to take a well-informed decision on future action regarding the legal instrument in question, namely amending, abolishing or retaining as is.

### **1.7. OECD Best Practices**

In 1997, the OECD published a report called “*Regulatory Impact Analysis: Best Practices in OECD Countries*”. The focus of this publication is specifically on regulations and identifies 10 “best practices” which can collectively be seen as prerequisites for good Regulatory Impact Analysis (RIA). These best practices are inter-dependent.

They also incorporate the recognition that RIA must be part of a larger system if it is to be effective. RIA must be **integrated into the overall system of policy development** and not an add-on in the last stages of policy-making. Drawing on the experience of its Member countries, the OECD recommended that governments address the following points when conducting RIA:

- **Maximise political commitment.** This is essential, especially to ensure that commitment to RIA remains robust when in conflict with other political pressures. Ministerial accountability for compliance is a key element of this.
- **Responsibilities must be clearly & carefully allocated.** This involves government, parliament and the administration. In the administration, regulators must be responsible for conducting RIA while *an oversight body is needed to ensure consistency, quality control and training.*
- **Training is essential** to ensure regulators have the necessary technical skills *and understanding of the importance/value of RIA.*
- **Analytical methods** must require a broad view to be taken, and the cost/benefit principle should be adopted for all regulations. However, the realities of data limitations must be

recognised, as must the need to use and integrate the quantitative and the qualitative. Mandatory guidelines on analytical requirements should be issued to ensure consistency.

- **Data collection strategies** must be developed. Quality data is needed in order to achieve a quality assessment. Strategies for obtaining good data at low cost must be developed and disseminated.
- **RIA effort must be targeted** to regulations that have important impacts and to situations where the results have the possibility of making a major difference to the outcome. This means “full” RIA for major regulations, a moderated effort (but with the same analytical basis) for a large “mid-range” and exemption of machinery/insignificant regulation.
- **Integration with the policy process.** RIA should start sooner rather than later so that it can really drive the broad policy choices as opposed to being an apology for decisions already made.
- **Communicate the results.** Both those inside and outside the bureaucracy who are able to influence policy choice must have the results of the RIA to carry out their role in the subsequent policy-making processes. Transparency is also the key to the integrity of the system.
- **Apply RIA to existing as well as new regulations.** RIA should be used when an existing regulation is reviewed and revised as it will improve the systematisation of those reviews and the likelihood that they will lead to better outcomes.

### *Improving Regulatory Quality*

In 1995, the OECD Council passed a Recommendation on Improving the Quality of Government Regulation. It includes a regulatory quality checklist that formulates the basic requirements for making high quality regulation.

The recommendation contains 10 questions that policy-makers should ask about any regulation they are about to pass (and also to existing ones). These are:

- Is the problem correctly defined?
- Is government action justified?
- Is regulation the best form of government action?
- Is there a legal basis for regulation?
- What is the appropriate level(s) of government for this action?
- Do the benefits of regulation justify the costs?
- Is the distribution of effects across society transparent?
- Is the regulation clear, consistent, comprehensible and accessible to users?
- Have all interested parties had the opportunity to present their views?
- How will compliance be achieved?

## **2. ASSESSMENT OF THE BUDGETARY AND ECONOMIC IMPACT OF GOVERNMENT POLICIES**

Proposals involving public expenditure invariably exceed the resources available to fund them. Making choices and setting priorities are unavoidable responsibilities of government. A systematic assessment of all proposals involving the public sector helps to ensure that good choices are made and that good value for money is obtained. Impact assessment helps policy-makers to achieve this. It is worth emphasising the point made in Chapter 1, however, that impact assessment is merely a useful tool for efficient and effective policy-making and that it is not a substitute for taking decisions that involve both technical analysis and political choices. The remainder of this chapter, therefore, should be read within that context.

Estimating the net cost of a policy proposal is a particularly significant aspect of impact assessment. However, experience has shown that the most important contributor to the quality of policy decisions is not the precision of the calculations but the action of analysing the proposal from the initial stage. It is a mistake to assume that impact assessment is a way of producing the “right” numbers. The important thing is that the administration be able to identify both the likely consequences of the proposed policy and alternative ways of implementing the policy.

Nonetheless, costs are of particular concern in the modern era. Governments are under increased pressure to use public money more cost-effectively. Allocating resources from less efficient areas to more efficient alternatives is an important step in improving overall cost-effectiveness. At the very least, it also reduces the costs of government action.

To maximise cost-effectiveness, the concept of the cost to be considered should include not only direct costs but also a wider range of costs such as those associated with environmental and social impacts. While these issues add to the complexity of the exercise, they cannot be avoided if the assessment is to be comprehensive.

### **2.1. Types of Costs**

Costs can be broken into three basic groups. These are:

- Direct costs to government, including all lower levels of government - the cost of delivering a service or of administering a regulatory system;
- Compliance costs for business and citizens affected - administrative and paperwork (operating) costs and capital costs;
- Indirect costs to the economy in general, such as environmental and social effects or reduced competition, innovation and investment.

However, total costs are dependent on a number of factors that need to be considered from the beginning. For instance, there is a need to define the target group of the service or regulation to get an idea of the scale of the likely effects; the level of public support or resistance in the case of a new regulation; whether the problem it seeks to resolve would be best addressed by information, legislation or direct provision each of

which have different costs; and the degree to which a new service or regulation would place an increased workload on the administration.

The various possible costs are discussed below.

### **2.1.1. Direct Costs to Government**

The introduction of a new service, the expansion of an existing service or the inspection and enforcement tasks associated with certain policies may require additional staff resources. Any additional staff costs, whether caused by recruitment of additional staff or overtime, should be quantified. If it is claimed that the policy can be implemented within the responsible public administration body's existing resource allocation, the basis for this assumption should be clarified: for instance, by demonstrating that excess capacity will be available owing to some other programme being discontinued or scaled down.

A decision to reduce staff numbers in a particular area will save on salaries but may incur redundancy costs in the first year, and annual savings may be partly offset by an increase in social security transfers.

The introduction of a new service may incur significant start-up costs such as investment in buildings and infrastructure, investment in plant and machinery, legal and consultancy fees, training, etc. There may also be recurring costs for additional consumable materials such as paper, electricity telecommunications etc.

Quantification of the budgetary costs is also dependent on the acceptability and enforceability of the proposal. Different policies affect different sectors of the public or business and some will require more enforcement than others. For example a policy to extend social security benefits will be complied with automatically (although a possible increase in fraud may require more monitoring) whereas a regulation which requires industrial companies to comply with particular environmental standards will require a degree of monitoring and enforcement. If a policy or regulation is likely to require monitoring and enforcement, the following questions should be asked:

- How big are the target group(s) affected by the proposal and what are the consequences for the need for enforcement? This question should cover:
  - the probable degree of spontaneous compliance;
  - the necessity for monitoring compliance;
  - aspects relating to the scale of sanctions and opportunities for imposing them.
- How great is the burden of enforcement that is likely to be placed on the authorities? This should cover:
  - whether the effects are once-off or are recurring;
  - the level of resistance and whether overcoming resistance will require legal action or an awareness campaign.
- Which government organisations will be affected by the proposed policy and what are their conclusions concerning the feasibility or the costs of its implementation?

With regard to the last question, poor communication between ministries can lead to problems at a later stage. It is essential that all relevant ministries be consulted at an early stage in the process to minimise the level of unforeseen costs and negative side effects. In principle, regarding direct costs of government



ministries, there should be no unforeseen effects; if there are it usually means that there was a breakdown in the inter-ministerial consultation process.

The ministry with primary responsibility for the proposal, therefore, must consider all costs that impact on the budget - not just its own costs or the costs of agencies within its area of responsibility. For example, a proposal to attract a multi-national manufacturing company through the provision of direct financial aid might be the primary responsibility of the Ministry of Industry if the grant is to come from its budget allocation but it might also concern the ministries responsible for water supply (the factory could affect water quality or pressure in the immediate vicinity) and roads (road improvements are often necessary to facilitate transport of manufactured goods). It may also concern other government bodies. Any cost quantification, which omits the costs incurred by other administrative bodies, will be incomplete because they will have to provide observations concerning the costs and feasibility of issues relating to their areas of responsibility.

Another consideration is that government policies generally have an effect on the overall economy. For this reason, a proposal to raise additional revenue through a tax - for example, on the price of cigarettes - may cause a decrease in budget revenues if demand falls significantly. It cannot be assumed that consumption will remain constant and that revenues will increase. Quantification of the change in revenue is inherently difficult owing to its dependence on assumptions about changes in future behaviour. Nevertheless, the assumption made should be clearly stated so that it can be considered fully.

If, for instance, a decision to increase the price of cigarettes is taken on health grounds, the long-term savings to the budget (in terms of, for example, reduced hospital admissions) should be quantified also. Nevertheless, this raises the issue of unforeseen impacts of policies, such as increased smuggling of cigarettes. Policy-makers should try to consider all likely affects of the new policy so that they will not be surprised at a much later stage.

### **2.1.2. *Compliance Costs for Business and Citizens***

In assessing the impact of a policy on business, it is important to differentiate between the different types of burden according to whether they are due completely, partly or not at all to the policy. This is all the more important given that the source of this information for administrators may be consultation with interest groups. Such groups may naturally be tempted to exaggerate the cost. There may be cases where a factor that is presented as a cost has nothing to do with the policy and it should not be included in the calculations.

For example, all businesses have routine administration costs such as building maintenance and sales administration. A proposal that all buildings should conform to minimum safety standards would impose additional costs on some enterprises but it would rarely be correct for the cost of a new office to be attributed wholly to the new proposal. To take another example, businesses need to keep financial records for their own uses. While a specific legislative requirement might require that this information be collected in a different form and made public, again the administrative burden is only partly due to the proposal. Indeed, the requirement that companies produce an annual financial statement conforming to international standards generally should add to the value of a company which had not done so up to then, by making it more attractive to outside investors. It also protects reputable companies from less principled competitors.

There are also the administrative procedures that many enterprises would ignore in the absence of a legal requirement or some other form of external pressure. These add no value to an individual enterprise but may add significant benefits to society as a whole or even to enterprises taken as a group. Included here

might be an equal treatment policy, strict safety procedures, minimum age requirements for employees and tax compliance requirements.

In considering the likely business effects, the following questions should be asked:

- Which categories of business will be affected?
- How many will be affected?
- What are the most likely nature and scale of the effects of the policy for the businesses concerned? This question should cover:
  - Whether the effects are once-off or recurrent;
  - The evidence for these effects and the degree of uncertainty;
  - The consequences of the additional administrative cost for the different sizes of business (an increase in administrative costs may be absolutely the same for all businesses but the relative effect on a small enterprise would be far greater than on a large enterprise).
- How do the costs and benefits compare with the resources of the businesses being affected?
- What is the likely effect on the competitive position of the businesses relative to foreign competitors?

### **2.1.3. *Indirect Effects on the Economy in General***

The last question in the previous paragraph may have significant consequences for the economy in general. This leads to the question of the social and economic effects. For example, reducing cost structures would improve exporters' competitive position, possibly leading to expansion in local employment, increased sales, increased tax revenue for the budget etc. The opposite is also true. However, anti-competitive effects may be sometimes justified by the benefits of the new policy. For example, the development of measures to improve conditions of employment, provided they are consistent with local preferences, may have negative implications for economic growth but the quality of life will be enhanced for society as a whole.

Apart from employment and economic growth concerns, environmental issues must also be assessed. The following are some questions that should be asked:

- What are the consequences of the proposed policy for energy consumption and vehicle use?
- What are the consequences of the proposed policy with regard to pollution (including water, air or soil pollution)?
- What are the consequences for public health?
- What are the consequences of the proposed policy for available land space?

Consider for example a proposal to impose a significant tax on private vehicles in order to boost budget revenues. If the increase is excessively high, the following could happen:

- The number of new vehicles being purchased falls (thus offsetting the increase in tax);
- The rise in demand for additional public transport services cannot be met because the public transport sector is already at full capacity, leading to dissatisfaction on the part of the public;
- The average age of private vehicles rises, leading to more accidents;

- The increase in the number of older vehicles also leads to increased polluting emissions at a time when they are already very high.

On the other hand, a policy which leads to a rapid increase in the number of cars on the road without a complementary shift in policies affecting road space and public transport can lead to serious traffic congestion with negative effects for business and for individuals' quality of life, both in terms of longer travel time and pollution.

Asking the questions above would go some way to ensuring that the negative consequences do not occur. Of course answering the questions will prove more difficult than asking them. Nonetheless, even if the effects cannot easily be quantified, evidence from other countries would be of use in assessing the impact of such a proposal. Nearly all policy instruments have unintended costs and benefits. It is important to ask as many questions as possible at the appraisal stage so that these unintended effects can be identified and dealt with in advance.

## **2.2. Conducting an Objective Impact Assessment Exercise**

Although impact assessment helps to save money in the long run, it can be costly in itself. Care must be taken, therefore, to ensure that the exercise provides value for money. There is no point in conducting an assessment exercise, the cost of which is out of proportion to the effects of the policy or regulation in question. Furthermore, to ensure objectivity, all impact assessment exercises should follow a consistent format although larger capital investments will require more comprehensive studies.

It is also essential that the assessment is conducted so that the cost estimates are as robust as possible and will stand up to analysis and review by other experts. They also need to be made available in a clear format to political decision-makers.

In this regard, the questions listed below are important in ensuring that decision-makers are able to make the most informed decision.

- Are politicians willing to pay significant short-term costs in return for significant long-term gains? Politicians are mainly concerned with the electoral cycle even though the effects of government policies often extend over longer periods. A government may be reluctant to approve a measure that will incur a net cost during its term of office, with the benefits expected to flow only when a new government is likely to be in power. During times of economic crisis, such reluctance is all the more likely. Thus a government may concentrate on short-term priorities which are likely to boost its popularity.
- Have all the long-term effects and the short-term effects been included? Consider the example where a private construction company agrees to build a bridge over a five year period after which the government must over 20 years pay an annual fee for use of the bridge by the general public. The cost to the government is nil for the first five years but the long-term costs may be substantial. They must be highlighted. On the other hand, some benefits such as those associated with pollution control may only become apparent in the long term.
- Have the long-term effects and the short-term effects been properly calculated? Since benefits and costs which occur in the future have a lower present value than those that occur today, the values must be discounted to reflect this difference. Choosing the most appropriate discount rate is important and is a topic of considerable debate among economists. This is briefly discussed in the next section.

### 2.3. Discounting (Net Present Value Considerations)

There are several discounting methods available. More details about them can be found in standard textbooks on financial analysis. However, the most dependable method for comparing alternatives is the net present value (NPV) method. This is where the *net* revenues (or quantified benefits) of a project or policy are estimated; discounted using an appropriate interest rate; and then compared with the initial cost. The preferred option is that with the highest positive net present value.

The present value of a future benefit is calculated by using the factor:

$$1/(1 + r)^n$$

where  $r$  is the discount rate and  $n$  is the number of years after which the benefits will flow. If the net present value is positive (benefits in present-value terms exceed costs in present-value terms), the proposal can be recommended.

Discounting is the opposite of compounding, i.e. working backwards from a figure which is assumed to include a compound rate of interest. However, an important issue is the determination of the appropriate discount rate. Three rates are briefly outlined below.

- Some economists argue that the opportunity cost to the government of investing in a particular policy or project is the reduction in interest payments that would be achieved if the cash were invested in reducing government debt. They state that the discount rate should be the rate of interest on government debt.
- Others argue that a higher discount rate should be used because the reduced rate of interest at which government borrows fails to reflect that taxpayers bear the residual risk of government investment - particularly that of making good on the obligations to creditors. This argument supports the use of the commercial borrowing rate.
- Another argument is that social considerations mean that governments occasionally should be prepared to invest at lower rates of return than the rate of interest on the government debt. Proponents of this view argue that a lower rate, known as a social discount rate, should be used instead. The weakness with this argument is that it might encourage governments to invest in projects when the same resources could be invested elsewhere (either by the public or private sectors) at a higher rate of return.

Arguments on the appropriate discount rate are detailed and complex. They are outside the scope of this paper but can be found in standard textbooks or articles on the subject<sup>1</sup>. The important point at this stage is that costs and benefits over a period of time have to be valued at constant present-day values rather than at current prices.

### 2.4. Must Everything be Quantified

Qualitative assessment of benefits and costs can be quite useful in helping policy makers to make a judgement that on balance will have a net benefit for society. Where analytical skills are not well developed, where the cost of information collection is too high or where there is little agreement on how to value benefits, it may be necessary to rely heavily on qualitative rather than quantitative assessments.

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1. See also "Public Investment in EU Member States: Budgetary Management Discounting and the Cost of Capital" by Michael Spackman in *Journal on Budgeting*. (OECD, 2000).

However, the monetary valuation of policy effects, where this is practicable, greatly facilitates the comparison process by establishing an easily identifiable order.

It is impossible to construct a system capable of charting all the costs and benefits of any policy. Impact assessment demands that many assumptions are made and it is often associated with a great degree of uncertainty. This uncertainty can be compensated in part by reporting the information sources and the assumptions made in the explanatory notes to the draft proposal. The most important requirements in an assessment exercise are well informed and open minded consideration of alternative options, against well defined policy objectives, and consideration of those factors which cannot be valued explicitly in money terms, as well as those which can be explicitly valued.

Apart from analysis of the direct public expenditure implications of a proposed project or programme, there are a number of other analytical techniques that can be used. Two of the most common are cost-benefit analysis and cost-effectiveness analysis. They are discussed in the following sections<sup>2</sup>.

#### **2.4.1. Cost-Benefit Analysis**

The most comprehensive form of valuation is cost-benefit analysis, which values not only those costs and benefits that have market values but also other costs and benefits such as environmental impacts, leisure time or consumer surplus. However a policy that passes the cost-benefit analysis test should not automatically be implemented. Cost-benefit analysis helps policy-makers to prioritise expenditures but public expenditure resources are limited and there will always be some strategic or other wider issues, which has not been practicable to include in the numerical calculation.

While cost-benefit analysis ideally would be applied to all policy decisions, the form should be based on practical judgements about reasonableness and cost. Major intervention instruments might require cost-benefit analysis of major sub-elements so those elements that cannot be justified are excluded. For example, analysis of a public transport initiative involving investment in roads, buses, trams and trains might yield a net benefit but if, for example, the trams and buses were competing for the same passenger population, the less attractive of the two might have to be scaled back or discontinued. At the other end of the spectrum, a proposal to increase employment in a social security office for a region where unemployment has increased dramatically would not require the same level of assessment. The costs can be provided readily by the ministry responsible for Social Security.

The most fundamental attraction of cost-benefit analysis is that a wide range of policy effects is valued. However, there may be difficulties with the availability of comprehensive data, there may be a shortage of analytical skills or there may be budget constraints. In the majority of areas of public policy, such as law and order, defence, employment, regional, industrial, education, health, or public administration, it is rarely possible for outputs to be explicitly valued. For these reasons, less comprehensive but also less complex and less time consuming alternatives such as cost-effectiveness analysis or financial analysis (comparing the effects of alternative options on government cash flows) might have to be used.

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2. The sections “cost-benefit analysis” and “cost-effectiveness analysis” are mainly taken from “Improving the Analytical Basis for Regulatory Decision-Making” by W. Kip Viscusi in *Regulatory Impact Analysis: Best Practices in OECD Countries* (OECD, 1997). For a more comprehensive presentation of these and other analytical techniques, this publication should be referred to.

### 2.4.2. *Cost-Effectiveness Analysis*

Cost-effectiveness analysis calculates the cost per unit benefit but does not assign monetary values to objectives such as equal opportunity, decreased mortality or improved nutrition. This approach eliminates the difficulty of attempting to value all benefits explicitly, at the same time providing comparisons of the costs of different ways of achieving a particular objective. A choice can then be made as to which of these options (which all achieve the same or similar ends) is preferable. It provides an index of the *relative* costs to society of various options for promoting a particular policy.

Although cost-effectiveness measures have certain limitations that can make them inconclusive with respect to determining optimal policy, the measures of cost per unit of benefit achieved reflects both beneficial and adverse effects of a particular policy. These provide a useful guide to the relative merits of different policies. Although the fact that one policy has lower cost per unit of benefit than another does not necessarily make it superior<sup>3</sup>, decision-makers can use these measures in conjunction with their sense of the value of the objective being pursued to select the most cost-effective policies. In other words, the policymakers are responsible for conducting an implicit cost-benefit analysis using the cost-effectiveness results to underpin their judgement.

In addition, this type of analysis can also help in selecting measures on the basis of their falling within an acceptable range. This can be viewed as a loosely specified cost-benefit analysis where the difficult to quantify benefit value is not precisely stated. There is merely an effort to ascertain that the policy is within a reasonable range with respect to such benefit values. For example, a policy which reduces cancer fatalities by 40 each year at a cost of 50 000 euros per case could be attractive, whereas anything above a cost of 100 million euros per case could be considered too expensive. So if a cost-effectiveness analysis suggested that the cost of a policy to reduce cancer was well within this range, the policy could go ahead.

Cost-effectiveness measures are most beneficial when the government objective is defined broadly enough to allow comparison of many different policy alternatives for achieving it. They often provide useful guidance regarding the relative efficacy of policies' performance and opportunities for reallocating resources to maximise their net impact. However, cost-effectiveness measurement does not question the rationale of a policy objective. It takes as given the desirability of achieving a particular objective without asking why that objective is necessary. Its task is to find the least costly way of achieving that objective. The only policy tools eliminated from consideration are those that are clearly less desirable in reaching the desired result, i.e. those that provide less benefit at more cost. There should be therefore a broad consensus that the implementation of this test accomplishes a worthwhile objective.

### 2.5. **The Quantification of Costs**

Cost quantification should cover ongoing capital and recurrent costs. If the policy involves the creation of capital assets, the receipts generated by the use of those assets should also be quantified. It is necessary to include *all* costs including wages and salaries, maintenance and repair costs, capital costs *and* the opportunity costs of assets already in use.

As mentioned previously, different policies lend themselves better to certain types of analysis and it may be necessary to rely heavily on qualitative rather than quantitative assessments. If all costs or benefits cannot be quantified, it might happen that a particular option appears best if estimated cash values only are

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3. For example, it is most unlikely that a health programme which would benefit say 100 people at a cost of 50 000 euros per capita would be regarded as more attractive than an alternative programme which would benefit say 200 people at a cost of 75 000 euros per capita.

taken into account, even though another option with a lower cash value might have additional non-cash benefits or lower non-cash costs. When this happens, results should be presented in a form that enables Ministers to choose whether, in selecting the alternative option, the additional non-cash benefits (or lower non-cash costs) are worth the loss in cash value. Pollution is a good example, since it involves social costs that cannot be valued accurately. Information should be given in the assessment to enable the decision-makers to judge whether the differences between the costed net benefits of alternative projects are outweighed by differences in their pollution effects.

## **2.6. Important Factors other than Numerical Calculation**

In talking about cost quantification, however, there is a need to avoid an over-emphasis on numerical calculation. For instance, the appropriate discount rate is important but there may be a danger that this numerical calculation gives a false sense of accuracy and completeness. There are many other important issues such as setting clear objectives, avoiding optimistic bias and a thorough analysis of risk. Bias and risk deserve some further discussion.

Important aspects of the assessment will necessarily be based on assumed future outcomes and events. These assumptions must be realistic whether they are about prices, costs, market growth or any other factor. They must always be clearly stated in the report. Where possible, assumptions should be based on analysis of *past* performance, bad years as well as good and careful study of future developments. It is important to make an allowance for the possibility of optimistic bias in the projected costs and benefits.

Realistic assumptions reduce but cannot eliminate the element of uncertainty in the decision-making process, and thus, the risk that the decisions made on the basis of the assessment may turn out to be wrong. Good policy impact assessment highlights the elements that are uncertain so that the decision-makers are aware of the risks involved in proceeding - or not proceeding - with a particular policy. To minimise risk, there should be a regular review strategy, which assesses outcomes against the benchmark assumptions and targets so that a wrong decision can be reversed as quickly as possible. This should ensure that budgetary and economic problems are minimised.

Finally, with regard to actual sources of funding, it must be stressed that foreign assistance for a particular project or policy should not lead to a less rigorous assessment than if that assistance was not forthcoming. Foreign aid is a national resource and must be used as effectively and efficiently as any other. This is especially important, as foreign funding may only be available in the short-term even though administrative costs are long-term. Another point is that policy-makers should be satisfied that these funds are being utilised in the most cost-effective manner and are not being spent on programmes, the benefits of which may not be as good as some other alternative.

An example of this is where the European Union (EU) expects its Member States to make the most cost-effective use of EU co-financing. For instance, Structural Funds Regulations provide that "In order to gauge their effectiveness, Community structural operations shall be the subject of prior appraisal monitoring and ex post evaluation, designed to appraise their impact with respect to the objectives set out in Article 1 and to analyse their effects on specific structural problems"<sup>4</sup>. The same regulations also demand that the Commission be provided with an analysis of the costs and socio-economic benefits of

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4. Article 6.2, *The Framework Regulation*, Council (EEC) No. 2081/93.

many projects benefiting from EU aid. More information on this topic can be found on the Commission web site<sup>5</sup>.

## 2.7. Conclusion

This chapter has concentrated on those factors which help to ensure that the cost assessment exercise is as comprehensive as possible so that policy-makers have the best possible idea of likely costs and benefits. However, it has to be acknowledged that in many instances, an impact assessment exercise will not be easy to do owing to the various complexities associated with the exercise and/or a shortage of skilled micro-economists. There is a danger that this difficulty will discourage policy-makers or administrators from conducting such an exercise in the first place.

As stated at the outset of this chapter, estimating the net cost of a policy proposal is a particularly significant aspect of impact assessment. However, experience has shown that the most important contributor to the quality of policy decisions is not the precision of the calculations, but the action of analysing the proposal from the initial stage. While there are complexities, there are also a number of important factors that can be covered relatively easily. These include setting clear objectives, avoiding optimistic bias and a thorough analysis of risk.

Finally, it has to be said that even the best impact assessment exercise will be useless if the policy-makers do not use it as a policy tool. Again, it is worth repeating that it is an aid to making a well-considered decision but that it can never be a substitute for making choices and setting priorities that are the unavoidable responsibilities of all governments.

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5. See <http://europa.eu.int/comm/dg19/evaluation/en/goodpracticeen.htm> for *Good Practice Guidelines for the Management of the Evaluation Function*. The guidelines refer to several Commission publications in this area, including *Guide to Cost-Benefit Analysis of Major Projects* available from Evaluation Unit of DG XVI, tel.: 295.16.85 / 295.72.79. This guide is specifically designed for Commission officials, who are not specialists in Cost-Benefit Analysis (CBA) but also gives some indications to external experts, who may need to understand the Commission's specific needs for information on costs and benefits of proposed projects.



### **3. CONSULTATION IN IMPACT ASSESSMENT**

Consultation has always been an acknowledged means to create consensus, explore ideas, improve acceptance of new proposals, find cost-efficient policy solutions and increase transparency in decision-making. It is accepted that good governance is, to a significant degree, based on proper consultation mechanisms, which are taken seriously by all parties.

Despite this general acceptance of consultations as a means for good governance, some public administrations and politicians often perceive consultations with interested parties as surrendering power. Indeed, it is often seen as an obstacle to taking optimal and clear policy or management decisions and as significantly slowing down the decision-making process. Of course badly managed consultations may have all the negative impacts listed above. However, well-prepared and managed consultations improve the information base for decision-making and increase the chances for consensus and cost-efficient policy solutions. In addition, such consultations reduce the likelihood of changes or even withdrawal of a policy instrument because it was based on wrong assumptions or insufficient information.

This chapter focuses on consultation as an information-gathering instrument for impact assessments. Consultation in the broader context, e.g. to promote democratic values, to foster policy acceptance, and to increase transparency, is not covered in this chapter.

#### **3.1. Why Undertake Consultation**

The objective of consultations is, like all other techniques and methods used in impact assessment, to improve the analytical base of government decision-making and to this end gather information on all consequences of government decisions, be it an investment measure, a new law, or possible amendments to existing laws. The desired information should include not only the possible impact on the state and local budgets, but also the impact on different groups of society, on economic actors, etc. For example, new tax laws, investment codes, environmental provisions, or professional health and safety regulations are likely to have a great impact on small and medium enterprises and the labour market, but they may also have side effects for other groups of society. In particular, unintended side effects should be detected during consultations, as they may create unexpected costs when the instrument is implemented.

However well informed, the civil servants preparing a government decision will never be in a position to have a complete overview of all possible consequences of a new policy instrument, in particular if it is of a complex nature. In addition, the civil servants preparing the instrument are usually located in policy departments in central ministries and may therefore not be in a position to thoroughly assess problems that may surface when implementing the new instrument.

Often, sufficient statistical data about the area to be regulated is not readily available and prior experience or research may be limited. Also, there may not be a sufficient number of trained staff to carry out impact assessment or carry out a cost-benefit analysis. If administrative capacity is still weak, the data collected during the consultations may be the major base for the impact assessment.

Consultation with other ministries will already improve the information base considerably. Consultation across levels of government, including executing administrative bodies, is necessary if the instrument is to have an impact on their budgets, procedures, workload, etc. NGO's, such as employers' organisations, trade unions, environmental groups, etc., as well as academia, depending on the subject matter, may often dispose of the missing information and even statistics. The information gathered from special interest groups may be biased, since they defend the interest of a specific societal group. This possible bias has to be balanced by the civil servants through careful examination and cross-checking of the provided data.

Consultation, when evaluating an existing instrument is necessary to ascertain the real impact of an instrument. This consultation should include the implementing administrations, the addressees of the instrument and those who are directly or indirectly affected by the instrument. In order to have constructive, rather than destructive, feedback from the various addressees, their experience with the policy instrument should be taken as a valuable source for the evaluation of the instrument and should be taken into account when considering possible amendments.

### **3.2. When to Undertake Consultation**

Consultation should be a built-in part of all forms of impact assessment as described in Chapter 1: namely, impact assessment for choosing the instrument, impact assessment of the draft instrument, and impact assessment for evaluation of the instrument.

As a general principle, consultation should take place as early as possible in the policy development process. It should always be done before a decision is taken. In order to ensure that consultation yields useful information, the lead administration should work on the subject matter before beginning consultations and must prepare all consultations thoroughly.

Consultation should never be used as a justification of a decision already taken. Carrying out consultation without being willing to take the information into account and to consider it seriously is a waste of time and usually leads not only to a bad instrument, but also to difficult relations with those consulted.

It should be common practice to start consultations within the administration across all levels of government and only after the results of these consultations have been taken into account, to consult with NGO's or the public at large.

If the impact assessment is geared to choosing the policy instrument, i.e. the development and the comparative assessment of possible policy options, consultations should take place after the lead administration has developed and sketched out possible policy options (see the example below). These options, their feasibility and their probable impacts are then the subject of the consultations.

If impact assessment is geared to assess the possible impact of a draft instrument, consultation within the administration should be an ongoing process. Every part or chapter of the law/instrument should be discussed with all the other administrative bodies who may have an interest in the regulated area.

If it has been decided to carry out consultations outside the administration, e.g. consult with NGO's and/or academia, the latest point in time for these consultations must be before the chosen policy option or draft goes to the Minister of the lead ministry for approval to submit it to the council of ministers. Good consultation practice would call for earlier consultation, to avoid possible substantive rewriting of the instrument due to oversights and wrong assumptions. It is common practice to make use of outside expertise during the drafting process if specific questions concerning the impact of a given set of regulations arise.

Consultation in the context of evaluating an existing instrument is defined by the timing of the evaluation, which may be set already in the substantive law or by decision of the government or parliament.

### **3.3. How to Undertake Consultation**

All consultations have to be transparent in the way they are carried out. Therefore, all consultations have to be well documented regarding those who were consulted, the issues on which consultation was carried out and the results of the consultation.

Those consulted must receive written information. The lead administration has to prepare this documentation. It should include, depending on the purpose of the impact assessment, either the description of the policy options or the draft law or the project document and, in addition, a definition of the main issues of the consultation and specific questions regarding these issues. These issues and questions should be grouped and targeted to the different groups/persons to be consulted. For example, there may be questions concerning implementation and enforcement targeted to the executing administration (police, customs, placement services, etc.); questions on feasibility and costs to insurance companies or public utilities and questions on the preferred mode of implementation and on compliance burdens to NGO's, etc.

The deadline for submitting the comments should be long enough to ensure that those being addressed have a chance to gather additional information. NGO's may have to consult with their members, the executing administration, e.g. district offices or local authorities and should be able to discuss the matter with the staff concerned.

A realistic deadline for comments could also help to increase the likelihood of receiving all useful information that those who are consulted can provide. It is common for those who might be affected by a government action to want to influence the policy or regulation by bringing forward arguments supported by data. Such data might take them some time to prepare, but if the issue is important, they may be willing to invest the time necessary for gathering information that can be very useful to decision-makers.

#### ***Example for consultations targeted to the assessment of possible policy options or a draft law:***

*Objective: Reduction of road accidents (usually formulated by the Minister/the government/the coalition agreement)*

The possible policy options or the main provision of the draft law have to be described in detail by the lead administration.

Possible options:

- (a) Do nothing.
- (b) Introduce and enforce speed limits with high fines and possible imprisonment (regulatory option).
- (c) In co-operation with insurance companies, reduce insurance contributions for drivers with no accidents (financial/incentive option).
- (d) Conduct an advertising campaign, publish statistics, etc. (informational option).
- (e) Investment programme to build more and better roads (government investment option).
- (f) Improve safety checks on cars and then raise safety standards (regulatory option).

After describing the options, the issues on which the administration wants information must be determined, e.g. as follows:

- Which option is easier to implement?
- What is the investment needed (short term cost)?
- What are the staff requirements (permanent cost)?
- Which option offers more incentive to comply?
- What can be expected in terms of benefits - accident reduction?

Finally very specific questions have to be formulated for the different target groups to be consulted and the different options envisaged.

Some examples of questions are noted below, but they are in no way exhaustive.

For option (b), increasing traffic controls and fines for traffic violations:

- Do the police forces have sufficient staff to ensure enforcement, do they have the cars, reliable radar systems, etc.; how much would it cost to equip them?
- Is the administration equipped to ensure and control the collection of fines (register of numberplates and addresses, etc.)?
- Is the envisaged internal administrative procedure for handling fines simple enough to avoid creating additional cost instead of additional income?

For option (f), improving the safety checks on cars and then raise safety standards:

- What political/social impacts may occur if safety standards for cars are raised (increase in the cost of cars and maintenance for the public)?
- What are the costs to governments and public transportation providers (increased cost of maintaining fleet of cars for government services and for public transportation)?
- If the private sector carries out the safety checks, how costly will oversight be? Which institution will be charged with oversight and at what additional cost?

For option (d), carrying out an advertising campaign:

- Are there any possibilities of having the information campaign paid by the private sector or having them co-operate in the effort?
- How much will it cost?
- What is the success rate of such campaigns in other countries?

During consultations inside the administration, it is understood that each ministry covers the issues within its own area of responsibility. For example, the Ministry of Finance is primarily responsible for assessing the budgetary impacts, the Ministry of the Environment for environmental impacts and the Ministry of Economics for economic impacts, etc. It being understood that if a new office needs to be created or staff need to be recruited to implement a new policy, it is the ministry in charge of implementation which may not be the lead ministry for the new policy instrument who has to assess the impact. However, as new

investment and staffing incurs budget costs, the Ministry of Finance also has a responsibility to assess these costs.

Consultations with parties outside the administration should address specific questions. It should be ensured and carefully observed that the consultations include all groups that may have an interest in the new policy programme and that the results of the consultation are documented. The administration has to make sure that the interests of those groups which are not well represented by NGO's, e.g. elderly, children, etc. are also taken into account.

Consultation in the context of impact assessment for evaluation of an instrument has a different objective. In the evaluation process, consulting with the administration and those groups of society targeted by the law means asking for real experience with the law and hard data, and possibly also for recommendations for amendments. It is not a case of forecasting possible impacts but looking at those that really occur. It is therefore self-evident that a good evaluation has to collect data, not only from those who have to implement the instrument, but also from all those on which the instrument was supposed to have a positive or negative impact. Avoiding consultation of the direct addressees and the wider target group of the instrument and their interest groups in an evaluation would most likely distort the results, because any evaluation is an empirical comparison between the expected results and the real results of the instrument.

### **3.4. Which Forms of Consultation are Possible**

Consultation inside the administration may be carried out under a written procedure or take the form of inter-ministerial meetings. If consultations are in written form, all comments should be communicated to all participants. If consultations are oral it is preferable to invite representatives from all the interested administration to the same meeting in order to have a complete exchange of opinions and clarify the different viewpoints.

Consultations outside the administration may also take place under a written procedure or at a public hearing. In recent years, some countries have started to consult interested parties and the public at large via the Internet. This form of consultation is cheaper than the traditional form, as no documentation has to be sent out. It has the advantage that everyone interested can comment on the proposal. On the other hand, it has the disadvantage that asking for specific information becomes more difficult. Until now, little information has been available on the acceptance of this form of consultation and on the quality of information gathered in this way.

Some legislation or investment programmes which have a considerable impact on a large group of citizens in a specific area have — by law — to undergo public consultations before they can be adopted. This is particularly true for infrastructure measures, such as new airports, motorways, railroad tracks, or a new space plan, which may affect the value of property.

### **3.5. Whom to Consult**

Consultation within the administration should always include the ministries which have horizontal responsibilities. These are primarily the Ministry of Finance (budgetary cost), the Ministry of Justice (constitutional and legal), and the Ministry of the Interior (organisation and implementation). Depending on the distribution of tasks within a given country, there may be other ministries that should always be consulted, e.g. regarding allocation of staff or execution of the instrument by local authorities. In general, it is good practice for governments to provide information internally on all projects, so that ministries are able to inform the lead ministry about their wish to be consulted on any given project. Consultation across

levels of government is usually done, not only via the ministry with responsibilities for local government, but also via the associations of local government.

It is advisable to consult with groups outside the administration for any instrument that may have an effect on the interests of specific groups of society. For a variety of reasons it is difficult to ensure that all interested groups of society are consulted; some of the groups may not have organised representations, others may be organised but their organisation not known by the lead administration. To reduce the probability of neglecting certain groups, it may be advisable to create a register at the centre of government where all NGO's can register, making their interests known and the topics on which they wish to be consulted. Consulting all those listed can avoid biased consultation or being reproached for biased consultation.

Countries such as Switzerland have a long tradition of direct democracy and of consulting the public at large. Consulting the public at large may be very lengthy and costly, if not done via internet, and the costs of preparing the documentation and its distribution may not be proportional to the results. Broad public consultation with written documentation distributed to the citizen may therefore only be useful on major proposals where the impact on citizens is expected to be very significant. One example is, of course, changes to the constitution. However, significant changes to the pension system or education system may also benefit from broad-based consultation.

#### **4. SPECIAL APPLICATION OF IMPACT ASSESSMENT TO THE PROCESS OF EUROPEAN INTEGRATION AND TO THE ACCESSION NEGOTIATION PROCESS**

##### **4.1. Introduction**

Countries preparing to join the European Union are faced with the enormous task of transforming their economic, social, legal and governmental structures. The countries of Central and Eastern Europe are doing this in the context of their integration into Europe, as well as into the broader context of “Western-style” governance, globalisation, and world trade. Of these countries, the 10 candidates are currently pursuing a vast strategic project of achieving accession into the European Union (EU), while others are seeking to achieve candidate status. All of this places a heavy burden on governments within a relatively short time to develop policy; to draft and pass legislation and regulations; and to build institutions capable of effectively implementing and enforcing them.

There is now a very significant series of interlocking tasks, which governments and national administrations in the candidate countries have to undertake. These include:

- following on from the screening process, preparing the overall negotiating position in detail;
- revising and updating the National Programme for the Adoption of the *Acquis* (NPAA) on a regular basis;
- implementing the NPAA;
- institution-building;
- programming of Phare and other assistance;
- preparing, programming and implementing the Instrument for Structural Policies for Pre-Accession (ISPA) and the agricultural fund (SAPARD) after 2000;
- communicating with NGO’s and the general public;
- preparing and training the public administration for participation in EU decision-making.

The purpose of this chapter is to show how the techniques of impact assessment can assist the countries of Central and Eastern Europe to perform some of the tasks related to European integration and EU accession. In the specific context of policy on European integration, the aims of impact assessment are essentially to provide governments and the private sector with information on the political, economic, social, and environmental impact of adopting Community policies or individual Regulations and Directives. Ideally, the results would be quantitative estimates of net costs and apportion them to different financial sectors - the national budget, regional and local budgets, private sector, consumers and so on.

But even where precise quantitative information cannot be obtained, qualitative information can also be of considerable importance. For instance, it will often be possible to indicate the implications of a measure for domestic institutions, without being able to specify exactly what the costs of such changes are. Indeed, in some cases qualitative analysis may be important to highlight problems which need to be tackled, but

which do not involve clearly attributable costs. For example, the role of the institutions providing border control may have to change upon accession to the EU and time will be required to prepare the management and staff for these changes in a way that causes the least disturbance. Good analysis and clear understanding of the impacts of the proposed changes, both quantitative and qualitative, would help smooth the transition and minimise human resource problems and service discontinuity.

#### 4.2. Applicability of Impact Assessment to EU Accession

It is sometimes said that because joining the EU requires candidate countries to adopt and implement the *acquis communautaire*, impact assessment is pointless since the candidate country has no choice. This is not true. There are different ways of bringing a country's legal framework into line with EU requirements. The reason for this lies in the nature of EU legislation, which takes two main forms:

- *Regulations* must be adopted in their entirety and without amendment by Member States; they are used where complete uniformity is considered necessary to achieve the ends of the legislation.
- *Directives*, in contrast, are much more flexible. They consist of "Common Essential Requirements", which must be incorporated into legislation by Member States. However, it is left to Member States to determine precisely how they do this.

This gives candidate countries considerable flexibility in the way in which they implement EU Directives, and these different ways of implementation can have very different impacts on the economy and society. Impact assessment is crucial for determining the most advantageous way of implementing Directives. Even where the implementation of a requirement leaves the candidate country little discretion, as is often the case with Regulations, impact assessment is still important because it is a guide to policy-makers on the impact that implementing the Regulation will have on other policy variables. In addition, analysis of the impacts of Regulations can assist in prioritising the timing of implementation of different Regulations, and also in budget planning, in explaining the regulation to those affected and securing their co-operation, and in designing the institutions for implementation.

In this context, it should be noted that:

- The processes and techniques for conducting impact assessment are generally the same with respect to policies and legislation related to European integration and EU accession as they are with respect to all other policies and legislation. (A number of exceptions and special considerations to this will be noted in this chapter.) The issues and techniques discussed in Chapter 1 on Improving Policy Instruments through Impact Assessment, in Chapter 2 on Assessment of the Budgetary and Economic Impacts of Government Policies, and Chapter 3 on Consultation are relevant to EU accession, and will not be repeated here.
- Impact assessment does not replace other processes and strategies for pursuing integration and accession. Its purpose is to contribute to the development and improve the effectiveness of other strategies, and/or reduce their costs and negative side effects.
- The conduct of impact assessment is itself a *cost* in terms of time delay and human and budgetary resources. In the case of EU accession, the candidate country is being asked to adapt thousands of individual pieces of regulation, as well as much policy in a relatively short time period. It is inconceivable that a country can undertake serious impact analysis of all these changes. Impact assessment must be carried out in such a way as to identify the crucial areas of impact on the national economy and society and to concentrate impact assessment on these areas.



In general, impact assessment should be carried out only when the expected benefits from the results of the assessment can reasonably be expected to outweigh the costs. However, it is important to have a broad view of “expected benefits”, and not consider them only in terms of financial and economic costs. Some other benefits such as greater equity, increased accountability, greater respect for the rule of law, and improved capacity in the administration should also be considered.

### **4.3. How Impact Assessment Can Contribute to an Effective EU Accession Process**

As was shown in the other chapters, impact assessment is an element of policy development designed to improve the information available to decision-makers. In the case of EU accession, impact assessment can assist decision-makers to optimise the process by:

- facilitating the processes of prioritisation and sequencing in policy-making and the adoption and implementation of the *acquis communautaire*;
- providing estimates of the costs of different approaches to the implementation of Community policy or measures and therefore to act as part of the evidence needed by government to make policy decisions;
- providing information on the impact of measures on the public and private sectors in order to provide information on changes which will be required in institutions, management, and production processes;
- measuring quantitatively the impact of measures on the national (and where appropriate regional and local) budgets and on the financing needs of companies.

Whenever there is more than one way to proceed, a choice has to be made. This applies to choosing a policy direction, a policy instrument, a method for implementation and enforcement, an institutional design, a negotiation strategy, and the appropriate timing to proceed. All such choices benefit from better information about possible consequences; it is the task of impact assessment to supply such information, both quantitative and qualitative.

#### **4.3.1. Cost-Effective Adoption and Implementation of the Acquis Communautaire**

This is the broadest and most fundamental area to which impact assessment can contribute. The estimated cost to European firms of responding to EU and national administrative requirements amounts to 540 billion euros per year (3-4% of GDP). In addition, there are budget costs to various levels of government. Failure to choose the most economical and efficient way to implement the *acquis communautaire* can reduce competitiveness of the country compared with other EU Members. There is obviously scope for savings for individuals, firms and governments if the implementation is well thought out in terms of how, and in what order it is accomplished.

The preparation for integration in the European Union is a complex exercise in cost minimisation. In spite of what is often said, there is not one way to join the EU, there are many ways. These different ways can have very different impacts on the economy and society. In order to choose the optimal route to the European Union, it is necessary to know what the political, economic, financial, legal and social impact of adopting EU policy and regulation is and what the different ways of implementing specific policy decisions imply for the country.

Less than optimal adoption of EU policy will not only increase costs, but could also decrease the benefits in terms of economic efficiency and competitiveness that are expected from EU accession. To help avoid such consequences, impact assessment can be used to search for approaches that:

- ensure that the implementation of the social aims of the *acquis communautaire* (e.g. environment) do not cause higher than necessary economic costs to the private sector;
- reduce the cost of providing public services to avoid generating tax-related disincentive effects and tax avoidance behaviour;
- ensure that the costs and delays to economic actors of obtaining public services and interacting with the administration (e.g. obtaining a licence) will not be higher than necessary;
- rely on voluntary compliance, which experience shows is often a cheaper way for industry to comply with EU Regulations than administrative control.

For these reasons, impact assessment should be, as much as possible, a regular aspect of the legal harmonisation process. Ministries and working groups preparing the country's legal instruments to apply the *acquis communautaire*, should, to the extent possible, consider in the normal course of their work the impacts of alternative approaches to converting Directives into national legislation, and identify the costs and benefits of all significant EU legislation. Where there are important implications, or significantly different impacts for different approaches to implementation, this should be brought to the council of ministers (or the appropriate ministerial committee) to inform decision-making.

#### **4.3.2. Institution Building**

The administrative arrangements and the institutions required by the country to implement the *acquis communautaire* are for the most part not prescribed by the EU, but left to each country to design and implement. Given that the *acquis communautaire* raises functional issues to be answered rather than prescribing institutional solutions for adoption, the challenge for institutional design becomes one of seeking to ensure effective conformity at least cost.

This approach opens up a wide range of institutional options. With respect to various parts of the *acquis communautaire* it is necessary to ask questions such as:

- Should particular EU legislation be implemented by modifying existing institutions, or should a new institution be created?
- Should the delivery systems be public or private or both?
- How will delivery systems (whether public or private) be subject to internal and external control?
- What measures are needed to ensure full public accountability of the specific institutional format decided upon?

Experience shows that the Members of the EU have in fact chosen very different institutional approaches to implementing parts of the *acquis communautaire*. The lesson from Member States is that the burden on economic actors is shaped significantly by the way the *acquis communautaire* is transposed into national regulatory systems and by the design of implementing and enforcing arrangements. Building administrative institutions to implement the *acquis* also has heavy implications for the budget, in the immediate as well as the long-term.

In designing an implementation approach, the most important question is to decide what to optimise. This decision must be made on a number of fronts. First, given that the costs of enforcement efforts may begin to outweigh their benefits beyond a certain level of effort, close attention must be paid to the relative “value for money” of various enforcement strategies. Second, administrative regulation imposes both budgetary costs (paid by taxpayers) and economic costs (paid directly by enterprises and reflected in costs to consumers). Often there is a trade-off between the two. For example, a company may be audited by a private sector accountant paid for by the firm, or by an administrative inspector paid for by taxpayers. It is an open question as to which one is economically more efficient and which one is administratively more effective.

Using the methods discussed in the previous three chapters, impact assessment can be a central tool in identifying and measuring these very significant cost and effectiveness implications, both private and public, of alternative institutional design choices.

#### **4.3.3. Preparations for Negotiations, and Modification of Positions during Negotiations**

Impact assessment can contribute to the country’s preparation of its negotiation strategy by identifying areas where the country might wish to argue for transition periods or derogations, and by providing the empirical data (both quantitative and qualitative) for supporting these arguments.

In identifying areas for transition periods, it is useful to distinguish between “product regulations” and “process regulations”. Product regulations concern the nature of the product itself, for example, quality standards of food, emission standards of cars, labelling requirements, etc. Meeting product regulations is a requirement for the product to be traded within the EU. Process regulations, on the other hand, concern the conditions under which the product is produced, for example, health and safety standards in the workplace, or environmental standards of factories.

Negotiating countries should be prepared to take over upon accession all the product-related internal market *acquis communautaire*. There may be a few Directives that cause problems; these should be investigated and, if serious, raised in the negotiations. But these should be purely technical arguments e.g. that it is physically impossible with the best will in the world to implement a Directive on time for accession. Any attempt here to use derogations or transition periods to protect domestic enterprises, public or private, will complicate the negotiations and perhaps lengthen them considerably.

The process-related Directives should be properly impact assessed. The most important areas being environment, the social policy area (especially health and safety at work) and perhaps areas like transport. Where the impact of the Directive is going to be very significant and lead to a serious financing problem (or in some cases an institutional problem), a proposal for a transition period should be seriously considered.

The nature of the transition period that should be proposed will depend on the nature of the problem:

- Where the problem is a technical one of simply inadequate time to complete the implementation of a Directive before accession and where to take on the Directive is in the clear interest of the negotiating country, as short a time scale as possible should be adopted.
- Where implementation would cause serious financing bottlenecks, two possible transition routes should be considered:

- If it is nevertheless important for economic growth and macro-economic stability to adopt the Directive, the shortest, progressive transition period that is financially possible should be negotiated.
- Where the contribution of the Directive to growth, stability and employment is not significant in the short-term or perhaps even negative, long, back-loaded transition periods are best. An example would be the Urban Waste Water Directive. In the long-term, it is clearly in each country's interest to adopt this Directive, as it has significant benefits to consumers and the environment. However, there is little relationship in the short and medium term between implementing the Directive and economic growth or even social welfare, except in a negative way i.e. implementation is so costly that its financing would have a slowing down effect on growth. In this case, a long transition period, with most of the implementation coming at the end of the period (when the country's GDP is much higher) would be the ideal solution.

A solid basis of arguing for transition periods based on impact assessment would make for more convincing position papers. In addition, as negotiations progress, and as the country will inevitably have to give up some of its demands, the background information provided by impact analysis will also contribute to decisions on how to prioritise positions of national interest. Without such analysis, it will be impossible for the council of ministers to make serious decisions throughout the process of negotiations on which positions can be given up with the least cost to the country and which positions must be defended absolutely.

#### **4.3.4. *Communications with Respect to European Integration***

In most of the candidate countries of Central and Eastern Europe, the EU accession project is quite popular, and usually enjoys the support of the main political forces. But experience shows that such support cannot always be counted on to continue when hard decisions are made during negotiations, and as certain sectors experience negative consequences from the adoption of EU requirements. All countries, therefore, must engage in some process of public communications to ensure on-going support for the process.

Impact assessment can improve government communications by providing more extensive information to demonstrate how government decisions benefit society. Where difficult choices have to be made in the process of preparing and negotiating for EU accession, the impact on different segments of society is often uneven, and it is almost always unavoidable that decisions, even optimal ones, would raise at least some opposition in the public or within particular sectors. For example, the charging of a user fee for a service that is presently "free" is always unpopular. But if the government can provide solid data to show that this is the cheapest option in the long run, or that it is the most equitable choice, the decision might be easier to sell. The ability of the government to demonstrate that choices were made on the basis of solid analysis can always go at least some way toward ensuring support for the decisions.

In the preparation and subsequent modification of negotiating positions, transparency is a good policy. Clearly, time pressure will tend to work against a policy of informing the electorate of the position the government is intending to take. But if the government is seen to be taking positions without consulting and informing the public, this will lead to a fall in support for the whole integration process. Transparency will become even more important as the negotiations progress and as cherished national positions have to be changed in order to keep negotiations moving forward. It is therefore good policy to devote resources to consultation, information and public relations from the start of the negotiating process.

Solid information on the rationale for choosing among different policy and implementation options is particularly important *vis-à-vis* the parliament, which, as a result of accession preparations, will be asked to pass a stream of legislation to adapt national law to that of the EU. It is not uncommon for parliament to attempt to change legislation proposed by the government, and government needs to have convincing arguments to ensure that it passes the legislation required for the accession process.

#### **4.3.5. *Effective Membership***

Membership of the EU requires the national administration to participate extensively in European policy development. Civil servants in ministries must be able to respond to new proposed regulations, and to be able to assess, often quite quickly, how these might affect their own countries. The skills required to do this effectively often involve the same skills as those needed for impact assessment. Moreover, some impact assessment is now an obligation on policy-makers in the EU. An example is the EU Directive on environmental impact assessment, which obliges the public and the private sectors to estimate the environmental consequences of major construction projects such as the construction of roads or the building of new industrial complexes. Finally, making intelligent choices on programming EU funds also requires capacity to carry out impact assessment.

For these reasons, it is useful to keep in mind that investing now in carrying out impact assessment, and in training and improving the skills of civil servants in the relevant areas, is also an investment in raising the policy analysis capacity of the ministries, and thus in preparing them for tasks they will have to undertake upon Membership.

#### **4.4. *Impact Assessment: Setting Priorities***

While impact assessment can clearly be a useful tool for EU accession, it is equally true that the quantity of legislation and policy changes required in central and eastern European countries in the process does not allow them to carry out impact assessment of everything. Since resources are limited and time is short, it is necessary to choose where impact assessment itself is likely to be cost-effective. The basic principle is that the resources invested in impact assessment should be proportionate to the importance of the issue. Some assessment, however sketchy, should be carried out on any significant piece of EU legislation, but detailed impact assessment should concentrate on crucial subjects. Examples might be Regulations and Directives where there is potential for significant savings or are known to be problematic and difficult to implement, and items of strategic importance for the negotiations, such as politically charged areas and potential candidates for transition period.

There are at least five ways of identifying legislation that the country might wish to assess more extensively.

- Selection according to the nature and cost of the policy itself.

The difference between Directives and Regulations, and between product and process were already noted. Directives lend themselves to more extensive assessment, because there is more flexibility in their adoption, and so more options to explore. Process Regulations and Directives are more likely areas for transition periods than those related to product, and so, in the context of preparation of position papers, may be more obvious subjects for extensive impact assessment. It is worth noting that several of the most financially burdensome Directives were originally agreed with long implementation periods for the existing Member States, an argument that present candidates could use to obtain transition periods for themselves.

Moreover, it is in the area of the process *acquis* that the largest volume of investment, public and perhaps private, will be required. In the area covered by Community regulation, it is above all environment regulation and that covering health and safety at work that will require heavy investment. The total level of budgetary investment required to implement the process *acquis* far exceeds what the countries of Central and Eastern Europe can support, even in the medium-term. If infrastructure investment is added, it is clear that even assuming continuing high economic growth rates, taking account of the resources already planned in national multi-annual budget planning, and of the capacity of the private sector to finance certain of the necessary investments, full implementation will take several years. Private or private/public financing of investment will clearly help to accelerate adoption of the *acquis communautaire*, but in Directives such as those which lay down minimum levels of service, considerable pure budgetary finance will be needed. Given the enormous projected cost of these Directives, the potential for savings from proper assessment is correspondingly large.

- Selection according to the experience of the present 15 EU Member States.

In many cases, present candidates can use the experience of Member States to identify areas of the *acquis communautaire* where investment in impact assessment may pay off. For example, Directives where present Members have used very different ways of implementing may be worth exploring to choose the most suitable approach to the country's situation. Directives where implementation has been very costly or where significant unexpected consequences have resulted are also good candidates for full impact assessment. At the same time, the conduct of impact assessment in such cases could itself benefit from the experience of other Members, allowing candidates to reach conclusions at less cost by using information and analysis already available to Member States.

When considering impact assessment of potential items for transition period, candidates can look at Community Directives where transition periods are being given to Member States for the implementation of the Directive. This is particularly the case in environmental regulation, where in respect of the Urban Waste Water Directive Member States have up to 15 years to implement one particular element of the Directive. Obviously, such Directives are also likely to cause problems for new Members and their implications should be assessed carefully.

- Selection using the experience of the previous candidate countries.

Previous enlargements are not necessarily a good guide to where the main accession problems might lie. The most recent enlargement was to Austria, Finland and Sweden, but these countries had relatively few problems adjusting to the *acquis communautaire*, partly because they had already adjusted through the European Economic Area Agreement and partly because they had a level of regulation similar to that in the European Union. The accession of Spain and Portugal is perhaps more relevant from the level of development, but these two countries joined 15 years ago, before the "1992" programme for the completion of the internal market had really started. It is, however, clearly of interest to study closely the accession treaties of these different countries and to discuss the problems of accession with officials who were involved in their accession preparation.

For those countries that started negotiating with the European Union in February 2000, it is useful to look at the positions taken by the countries that began negotiations in Spring 1998. These countries have submitted all their position papers and most of these are in the public domain. Not all of those accession countries have completed impact assessments on the main areas of the *acquis communautaire*, but taking all the requests for transition periods, or other measures deviating from the *acquis communautaire*, into account gives a good idea of the key areas of potential problems.

- Selection based on the experience of officials in line ministries who have been involved in the screening process.

Officials in line ministries are those in government theoretically best equipped to identify problem areas. They should have a good knowledge of the sectors they are dealing with, and they should be aware of the major problems that their sectors face. They will also have taken part in the screening of EU legislation in sessions with the European Commission in Brussels.

One of the main problems here is sensitising officials in line ministries about the sort of problems, which may occur in their areas of competence. The co-ordinating authority in government on European Integration should usually have a role in stimulating line ministry officials to identify the important areas in which impact assessment should be used.

- Selection through consultation with business, unions and other interest groups in society.

Some of the areas that really need to be fully impact assessed will be apparent to the non-government sector but not to government. It is for this reason that business and other non-governmental sectors should be involved in the determination of areas in which impact assessment should be carried out. These non-governmental sources will, of course, also be necessary in the establishment of the facts in impact assessments concerning their areas.

## 5. REFERENCES, USEFUL GUIDELINES, WEB-SITES AND DIRECT LINKS

### 1. References

W. Kip Viscusi: "Improving the Analytical Basis for Regulatory Decision-Making" page 183 *Regulatory Impact Analysis: Best Practices in OECD Countries* (OECD 1997). This OECD publication lays out case studies and a step-by-step guide to good impact analysis.

OECD Recommendation of the Council of the OECD on Improving the Quality of Government Regulation (1995).

Article 6.2, *The Framework Regulation*, Council (EEC) No. 2081/93.

### 2. Useful Publications and Good Practice Guidelines

SIGMA PAPER No. 13: *Assessing the Impacts of Proposed Laws and Regulations*

SIGMA PAPER No. 15: *Checklist on Law Drafting and Regulatory Management in Central and Eastern Europe*

SIGMA Publication 1994 *Improving the Quality of Laws and Regulations: Economic, Legal and Managerial Techniques*

*EU Guidelines: Good Practice Guidelines for the Management of the Evaluation Function*. The guidelines refer to several Commission publications in this area, including Guide to Cost-Benefit Analysis of Major Projects available from Evaluation Unit of DG XVI, tel.: 295.16.85 / 295.72.79. This guide is specifically designed for Commission officials, who are not specialists in Cost-Benefit Analysis (CBA) but also gives some indications to external experts, who may need to understand the Commission's specific needs for information on costs and benefits of proposed projects. They are available at the following Internet address:

<http://europa.eu.int/comm/dg19/evaluation/en/goodpracticeen.htm>:

Australia (State of Victoria)

<http://www.dsd.vic.gov.au/dir0136/regreform/orrsite.nsf>

Australia (Federal Government)

<http://www.pc.gov.au/orr/reguide2/index.html>

Canada

[http://www.pco-bcp.gc.ca/raoics-srdc/raoic\\_e.htm](http://www.pco-bcp.gc.ca/raoics-srdc/raoic_e.htm)

The Canadian "Federal Regulatory Process Guide" is currently being updated. A new version should be available soon.



CCNM/SIGMA/PUMA(2001)1

Germany:

<http://www.staat-modern.de/projekte/index2.htm>:

See guidelines for impact assessment and guidelines for cost assessment in German:

(1) Leitfaden zur Gesetzesfolgenabschätzung (pdf)

(2) Arbeitshilfe zur Ermittlung der Kostenfolgen von Rechtsvorschriften (pdf)

United Kingdom:

[http://www.cabinet-office.gov.uk/regulation/1998/brg/brg\\_contents.htm](http://www.cabinet-office.gov.uk/regulation/1998/brg/brg_contents.htm)

In addition: more than 200 world-wide government sites can be found on the World Bank website:

<http://www1.worldbank.org/publicsector/civilservice/>

## 6. ASSESSING THE IMPACT OF LAWS AND REGULATIONS

### **Example of a regulation**

*included in the general working rules of ministries*

Translation of guidelines used in the Palatinate (Germany)

#### **Art. XX: Assessing the Impact of Laws and Regulations**

1. Assessing the impact of laws and regulations involves procedures for:
  - exploring the need, urgency and possible implications of alternative draft laws and regulations (prospective impact assessment);
  - examining and evaluating draft laws and regulations or parts thereof (assessing impact during drafting);
  - evaluating legal provisions already in force (retrospective impact assessment).
2. An assessment shall be made of the impact of any planned legislation that is broad in scope or likely to have significant consequences.
3. In assessing the impact of legal instruments, it is necessary to follow the guidelines in Annex XXX.

#### **Art XXX**

4. When the impact of laws/regulations is assessed, the results of the assessment, and the way they have been taken into account, must be presented in the rationale; failure to make such an assessment must be justified in the rationale.
5. Proposals to make a retrospective assessment of the impact of a law/regulation must be explained in the cover note accompanying the draft legal instrument.

## 7. ANNEX

### **Guidelines for Assessing the Impact of Laws and Regulations**

Assessing the impact of laws and regulations involves special procedures:

- to develop regulatory alternatives and to make comparative assessments of their impact<sup>6</sup>, and also for the motivated selection of the best regulatory option;
- to analyse and test draft laws and regulations according to a set of functional criteria
- to evaluate legal instruments already in force (on a one-off, continuous or periodical basis)

These procedures may be used in combination or singly. The method used depends on the particular law/regulation planned and on the criteria chosen for its examination.

#### **1. Prospective Impact Assessment**

This procedure is used to assess the need for a regulation, to define alternative regulatory options and to make a comparative appraisal of them in terms of their foreseeable effects (burdens, impact on societal developments, etc.).

##### ***Core objective:***

To determine which regulatory option promises the best possible means for meeting objectives — taking account of undesirable side effects.

##### ***Conception phase:***

- Exploration of the area to be regulated;
- Definition of regulatory options;
- Description of different possible developments in the area to be regulated (scenarios);
- Combination of the regulatory options with the different scenarios.

##### ***Implementation phase:***

- Estimation of impact with the co-operation of experts and group(s) targeted by the regulation;

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6. Regulatory in the context of these guidelines refers to all policy options, i.e. coercive, financial, informal and the zero option. In Germany a legal instrument is necessary for the implementation of all options except the zero-option.

- Drafting of a report on the assessment, in which the most suitable regulatory option is identified and recommended;
- The selected regulatory option provides the basis for the preparation of the draft of a law or regulation.

## **2. Assessing Impact During Drafting**

This procedure can be used for a variety of purposes when a regulatory option (previously selected on the basis of a prospective assessment where possible) is drawn up with the aid of documentation and checking/testing procedures. It may employ suitable techniques for checking and, where appropriate, modifying those parts which seem likely to have major repercussions.

### ***Core objective:***

To determine whether the regulatory purpose is fulfilled in the best possible way and is sustainable.

To determine whether the group targeted by the legal instrument can easily implement or comply with it.

To determine the extent to which the legal instrument increases/decreases the burden on its target group.

### ***Typical procedure:***

- Determining the assessment criteria (e.g. extent to which objectives are met, feasibility, costs) and the assessment methods/techniques (e.g. value-benefit analysis, simulation, cost-benefit analysis).
- Carrying out the examination and tests, in co-operation with the target group if possible.
- Determining whether the results of the impact assessment made during drafting vindicate the draft law or regulation or whether they entail well-founded changes and amendments.
- Documenting the results of the assessment as well as the changes in the draft.

## **3. Retrospective Impact Assessment**

This procedure is used to ascertain the actual effects of a legal instrument after it has entered into force as compared with the intended effects. This assessment may be a one-off, continuous or periodical exercise.

### ***Core objective:***

To determine whether the most important objectives of the legal instrument have been met (degree of success). To determine whether it is advisable or necessary to amend, redraft or scrap the existing instrument.

### ***Typical procedure:***

- Determining the assessment criteria (e.g. extent to which the objectives are fulfilled, acceptance, costs, actual impact and side effects in the area of application).
- Selecting the parts of the regulation to be evaluated (the whole law, sections likely to have considerable impact).

- Determining the date or periodicity of the evaluation (if not already laid down in the legal instrument).
- Determining suitable methods of evaluation (e.g. field research, surveys, hearings of the administrations applying the instrument, reports, comparison of actual outcome with expectations).
- Carrying out research/tests.
- Evaluation of results on the basis of the assessment criteria.
- Documentation of the motivated proposals for future action (with reference to prospective assessment(s) and assessment(s) made during drafting where appropriate).

#### **4. Application of Impact Assessment**

- The three procedures for impact assessment and the different stages in each one, shall be applied flexibly, in the light of political goals and practical necessities and in accordance with expenditure/time criteria.
- The methodology has to take account of the wide variety of regulatory instruments and assessment criteria; its use should be geared to particular problems and cases and it should be developed further.
- Existing documentation, e.g. manuals, as well as external consultation and in-service training should be used if necessary.
- Regular checks must be made in order to determine whether an institutionalised assessment of the impact of legal instruments is advisable and if so what flexible form it should take.