National Audit Office

BRIEFING FOR THE
HOUSE OF COMMONS
ENVIRONMENTAL AUDIT
SELECT COMMITTEE

JULY 2012

Appraisal and sustainable development

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Contents

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Summary

Introduction

1 The National Audit Office has prepared this briefing at the request of the Environmental Audit Committee. The briefing gives a high-level landscape overview of options appraisal processes across the government's decision-making landscape, with a focus on incorporating environmental and social factors in these processes.

2 The briefing is structured as follows:

- Part One outlines the landscape of decision-making across the range of central government activities together with the formal appraisal processes which have developed, including the impact on the UK of EU requirements for appraisal;
- Part Two sets out the guidance on appraisal, its central emphasis on cost-benefit analysis, approaches to monetisation of non-financial impacts, and other ways wider impacts may be taken into account.

3 This briefing was compiled on the basis of desk-based research of publicly available documents including previous National Audit Office reports and briefings on option appraisal and regulation, central guidance from the Better Regulation Executive (BRE) and the Treasury, material from departmental websites, and other published reports. It was supplemented by a limited number of interviews with staff in selected government departments,

Main findings

Appraisal in decision-making across government

4 The fundamental objective of appraisal is to ensure that government decisions are based on a rational consideration of options and their associated costs and benefits.

5 The landscape of decision-making across government is complex, reflecting the many different ways in which government operates to influence society. Departments must comply with statutory appraisal requirements and with government requirements, as set out in HM Treasury's Green Book and other related guidance. Formal appraisal systems have grown up in three main areas - the Impact Assessment process which applies mainly to regulatory interventions, the Business Case process, which applies to spending proposals, and most recently Tax Information and Impact Notes, which have been introduced to address the impacts of new taxation proposals.

6 Departments have to publish impact assessments in accordance with guidance issued by the Better Regulation Executive (BRE) within the Department for Business, Innovation and Skills. Impact assessments for regulatory proposals are subject to review by an independent expert committee, the Regulatory Policy Committee, before being submitted to the Cabinet Reducing Regulation Committee. Departments also produce economic appraisals of government interventions which are not classed as regulatory. These are also sometimes commonly referred to as 'impact assessments' but are not reviewed by the Regulatory Policy Committee or the Reducing Regulation Committee though they may be considered by other Cabinet committees.

7 The impact assessment guidance was revised in August 2011. It expects all costs and benefits to be monetised where possible, and emphasises the need to base analysis on the principles set out in the Green Book. Although the new impact assessment proforma no longer includes ten specific impact tests to address wider impacts, the guidance continues to emphasise the need to consider wider impacts in appraisals and to disclose the impact of each option on carbon emissions. Major new departmental expenditure programmes and projects are subject to Treasury approval on the basis of a formal business case, and departments are expected to apply the same discipline to their consideration and approval of smaller scale projects. As with impact assessments, business cases are required to address all impacts, including wider environmental and social impacts. Business cases may be subject to external assurance by the Major Projects Authority and may be published as part of a public consultation on a proposed new programme, such as High Speed 2 rail proposal, but many Business Cases are not published.

8 The requirement to produce tax information and impact notes was introduced in December 2010 to bring greater transparency to decision-making on budgetary measures, including proposals for significant tax changes and for new economic instruments. Tax information and impact notes present the final proposal, together with its likely impacts, for consultation. They differ significantly from both the impact assessment and business case processes because they do not set out the range of policy options considered.

9 Overall, these appraisal processes may not apply to all aspects of government decision making such as strategic expenditure decisions, decisions by statutory regulators, and new economic instruments. Examples include the commitment to increase spending on foreign aid and the decision to create the Regional Growth Fund. There are also significant differences between these processes in respect of their purpose, transparency, and consideration of risk. In particular, the process for taxation presents impacts of a chosen option rather than evaluations of a range of options. The National Audit Office has noted elsewhere that there is scope to improve the quality of appraisals and to bring the business case and impact assessment processes together (Annex 2).

Appraisal guidance and sustainable development

10 The Green Book and the associated guidance for impact assessments and business cases aspire to all costs and benefits being monetised to inform choices between options. The structured presentation of costs and benefits on a comparable basis and in monetary terms helps decision-making and the management of budgets across programmes. But it is not straightforward. In some cases, the use of cost benefit analysis can involve complex modelling to assess the likely long-term impacts of different policy options. It may not be possible to model indirect impacts, and the results may be subject to considerable uncertainty. Long-term estimates also involve the use of discounting to weight on a systematic basis the relative value of longer-term costs and benefits against short-term costs and benefits.

11 It is sometimes possible to bring non-monetary impacts into structured assessments of costs and benefits using financial values obtained through the use of preference based techniques, through assessing the damage cost of not addressing likely impacts, or through determining the cost of abating them. It is inherently challenging to develop methodologies that identify the value individuals place on wider environmental and social impacts and that allow consideration of impacts that may go beyond marginal change. The National Audit Office has concluded that there is scope to improve levels of monetisation by promoting its use and promulgating good practice, for example, by extending libraries of techniques and cross-departmental contacts. Recent supplementary Green Book guidance on accounting for environmental impacts provides step-by-step guidance on the types of impacts for which monetisation techniques might be appropriate.

12 Some impacts cannot be reliably monetised, and in these cases departments might consider approaches such as critical success factor or multi-criteria analysis, which involve listing all criteria relevant to a decision and agreeing a subjective scoring, and in the case of multi-criteria analysis weighting the criteria to produce a single overall score and rank the options. Alternatively, the results of assessments against each criterion can be presented either in tabular form or using graphics to allow policy makers to understand the range of impacts. Structured approaches to the consideration of non-financial costs and benefits can support more structured efforts to mitigate them or realise the benefits and monitor outcome. The National Audit Office has recommended the introduction of a requirement for the structured consideration of qualitative factors and improvements to the associated practical guidance.

13 Statutory targets and environmental limits can fundamentally change the nature of the decision-making process. When governments are committed to meeting statutory targets, decision-makers will compare the costs and benefits of options that meet the targets and may compare their relative cost-effectiveness and the extent to which they contribute to meeting the target. Where there are environmental limits it is important for decision-makers to consider the individual impact of a policy and cumulative impacts from other policies. The government has committed itself to the development of an 'asset check' to account for large, irreversible impacts on natural capital assets, such as biodiversity ecosystems, that are essential to social and economic activity. It has also established an independent Natural Capital Committee to advise on where natural assets are being used unsustainably.

Issues which the Committee may wish to consider further

14 Issues which the Environmental Audit Committee might be interested in pursuing are presented at the end of each part:

- Part 1 (paragraph 1.29) presents issues relating to the appraisal landscape, including the coverage of formal appraisal processes, the differences between them, and the role of the organisations involved; and
- Part 2 (paragraph 2.22) presents issues associated with addressing sustainable development and environmental impacts within appraisals, including the difficulty of identifying and quantifying the full range of impacts, the extent to which such impacts can be monetised, and approaches to assessing impacts which cannot be monetised.

Part One

Appraisal and decision-making

Introduction

1.1 The fundamental objective of options appraisal is to ensure that government decisions are based on a rational consideration of options and their associated costs and benefits. This Part of the briefing sets out the formal appraisal processes which have developed across the range of government decision-making activities; the statutory and non-statutory drivers for specific forms of appraisal; and the processes for appraisal within the EU of its initiatives.

Appraisal and decision-making

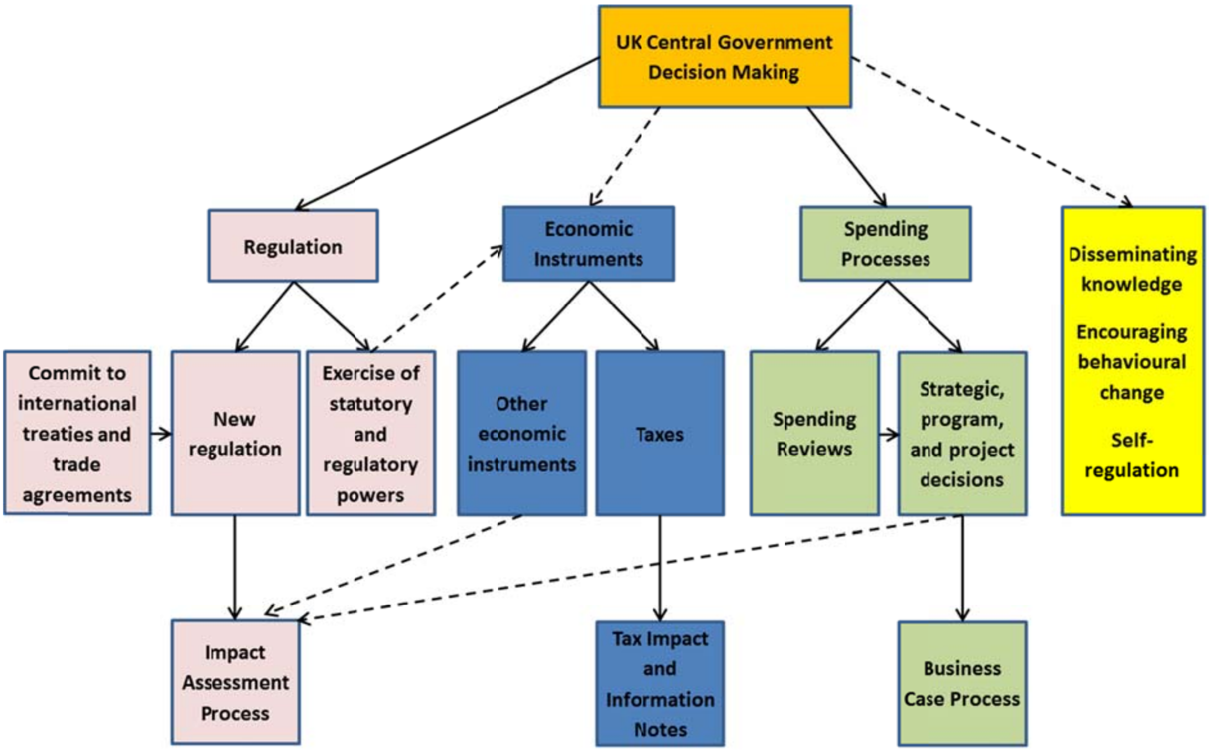
1.2 Government influences society in many ways:

- It raises taxes to finance government expenditure and to influence behaviour.
- It spends the money it raises on public services to meet government objectives, such as the provision of defence, health, education, and social welfare services.
- It imposes laws and regulations.
- It exercises statutory and regulatory decision-making powers, including legal judgements, planning consents, and environmental licensing.
- It negotiates treaties and trade agreements with other countries, and may pursue other forms of international action and cooperation.
- It may seek to change behaviour and raise awareness in the industrial, business, and domestic sectors.

1.3 Formal appraisal processes have evolved in two main areas - the impact assessment process applying to regulatory interventions, and the business case process applying to expenditure decisions (Figure 1). The guidance specifically differentiates between regulation and taxation and excludes the latter from the scope of the full impact assessment process, but arrangements for publishing greater information on tax decisions in tax information and impact notes have recently been introduced.[1]

[1] HM Government, Impact Assessment guidance, 2011, paragraph 1.12

Figure 1: Areas of government decision making



Source: National Audit Office

1.4 These main appraisal processes are non-statutory, though all departments are strongly expected to implement them. In addition, individual government departments may have their own appraisal processes to help them assess whether policies or programmes meet their objectives. They may therefore set their own policy specific appraisal requirements or guidance, to be addressed alongside or within impact assessments or business cases. Such guidance must be in accordance with the Green Book and other central guidance.

1.5 There are also statutory requirements for specific forms of appraisal at a policy or major project level (Figure 2). There is no central listing setting out these requirements and the types of appraisal required under international and UK law, but they include:

- EU requirements for member states to carry out specific forms of impact assessments, mainly in relation to equality issues and the environment. Environmental impact assessments must be undertaken for individual projects which are likely to have significant effects on the environment. Strategic environmental assessments aim to capture the wider environmental impacts of policies, plans and programmes (Figure 3). Both types of assessment may take over a year to complete. These directives must be followed at both a national level in relation, for example, to the siting of major power stations and windfarms; and at a local authority level in relation, for example, to the development of local authority waste and transport strategies.

- Legal judgments which act as precedents, which may require the government to give consideration to specific issues. For example, a European Court legal judgement in 2005 obliged the Department for Environment, Food and Rural Affairs to reconsider its guidance on flood and shoreline management plans and make them subject to appropriate assessment of their implications for special areas of conservation sites.

1.6 UK government decisions can be subject to judicial review if statutory requirements or associated procedural guidelines are not followed, with challenges typically relating to the legality of the approach, fairness and rationality or propriety.

Figure 2 : Main statutory drivers for appraisal

EU/UK Human Rights legislation

Aarhus Convention imposes duties on public bodies regarding environmental justice

EU Environmental Impact Assessment Directive (EIA) requires environmental assessments of individual projects in certain circumstances

EU Strategic Environmental Appraisal Directive (SEA) requires environmental assessments of wider programmes and strategies in certain circumstances

EU Habitats Directive specifies the need for an EIA in certain situations relating to land use planning

UK local planning legislation requires local authorities to conduct EIAs and SEAs in certain circumstances

ECE Espoo (EIA) Convention requires an EIA where major projects may have a significant adverse environmental impact across state boundaries.

Source: National Audit Office

Figure 3: Strategic Environmental Assessment case study

In January 2009 and in accordance with the EU Strategic Environmental Assessment regulations, the Department of Energy and Climate Change completed a strategic environmental assessment of a draft programme to hold further rounds of offshore wind leasing and offshore oil and gas licensing in United Kingdom waters.

The three alternatives considered were:

- Not to offer any areas for leasing/ licensing.
- To proceed with a leasing and licensing programme.
- To restrict the areas offered for leasing and licensing temporally or spatially.

The aims of the strategic environmental assessment were to consider the environmental implications of the three alternatives and the potential spatial interactions with other users of the sea. The assessment informed the UK government's decisions on the draft programme and provided routes for public and stakeholder participation in the process. Work done included scoping by academic and conservation organisations, surveys, technical studies, workshops and stakeholder meetings. The factors assessed were: biodiversity, habitats, flora and fauna; geology and sediments; landscape/seascape; water environment; air quality; climatic factors; population and human health; other users; material assets (including infrastructure and other natural resources); cultural heritage (including architectural and archaeological heritage); together with the interrelationships of all these factors.

The strategic environmental assessment concluded that there were no overriding environmental considerations to prevent the achievement of the offshore oil and gas, gas storage and wind elements of the programme; but that the preferred option was to restrict the area offered for leasing and licencing spatially through the exclusion of certain areas. It also recommended a number of mitigation measures to prevent, reduce and offset significant adverse impacts on the environment and other users of the sea - such as locating the bulk of new generating capacity well away from the coast (generally outside 12 nautical miles).

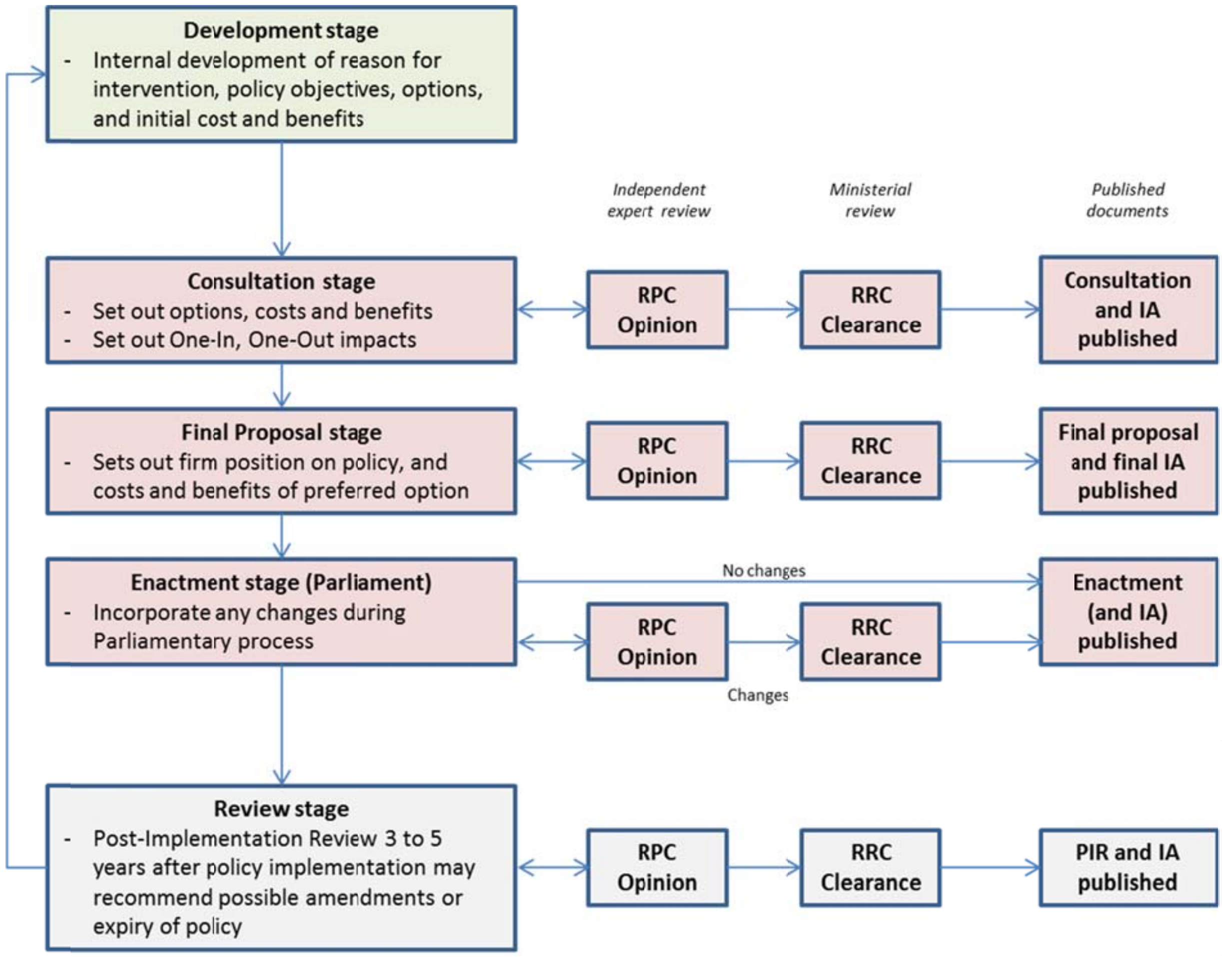
Source: National Audit Office

Regulation and the impact assessment process

1.7 Policy responsibility for the impact assessment process rests with the Better Regulation Executive within the Department for Business, Innovation and Skills. Impact assessments are required for all government interventions of a regulatory nature which affect the private sector and the voluntary and not for profit sectors; and for interventions with costs of over £5 million for the public sector.

1.8 The impact assessment process applies at various points in the policy development cycle through to the legislative stage (Figure 4). When policy options are initially developed, there is internal consideration of potential impacts. But the first published impact assessments are for consideration of proposals which are subject to consultation and are published alongside the consultation document. They are intended to address the policy options considered and the preferred option, their costs, benefits and impacts. The impact assessment process includes a requirement for there normally to be a post implementation review, three to five years after policy implementation.

Figure 4: The process for regulatory impact assessments



NOTES

1. RPC refers to the Regulatory Policy Committee, and RRC to the Regulatory Reform Committee

Source: NAO, based on HMG Impact Assessment Guidance (August 2011), page 22

1.9 Over the last three years, there have been important developments to improve accountability and the quality of the impact assessment process - in particular, the creation in 2009 of the Regulatory Policy Committee and in 2010 of the Reducing Regulation Cabinet sub-Committee.

1.10 The Reducing Regulation Committee is a Cabinet sub-committee established to manage the government's deregulatory programme. It is chaired by the Business Secretary and its membership is drawn from departmental ministers including the Secretary of State for Environment, Food and Rural Affairs. Proposals for new regulatory or deregulatory measures must be submitted to this committee in parallel to the main policy Cabinet Committee, but the Committee does not review impact assessments for some types of interventions. The latter include non-regulatory proposals which do not have direct impacts on businesses (for example, the Affordable Rent impact assessment); regulatory proposals where no impact assessment is required (for example, those which only impact on the public sector and by less than £5 million); or regulatory proposals which fall outside the cabinet committee clearance process (for example, proposals put forward by regulators such as Ofcom or Ofgem, or by arms-length bodies which are not subject to the Better Regulation framework). In the case of proposed EU measures which would impose a significant regulatory burden on the UK, the Reducing Regulation Committee provides a clearance letter to the Europe Committee.[2]

1.11 The Regulatory Policy Committee is an independent advisory committee established to review the quality of impact assessments and their compliance with the Better Regulation Executive's guidance, and to help reduce the burden on businesses and civil organisations from regulation. It considers impact assessments supporting proposals that are subject to clearance by the Reducing Regulation Committee. The Committee consists of six independent members including business, academic, trade union and consumer representatives, and is supported by a small secretariat of civil servants. The Regulatory Policy Committee is specifically responsible for assessing whether impact assessments are 'fit for purpose' and for validating the estimated costs and benefits to business of regulatory proposals subject to the 'One-In, One-Out' initiative.[3]

1.12 A department should not submit a regulatory proposal for Ministerial agreement without Regulatory Policy Committee agreement that the impact assessment is fit for purpose. The Regulatory Policy Committee uses a red, amber, and green rating system. If the impact assessment is assessed as 'red', then the department should amend it and resubmit it although it is not obliged to do so before submitting it for Ministerial agreement. The Committee publishes its opinions[4] and in 2011 issued 582 opinions in total, of which 465 related to impact assessments submitted by departments for the first time. It rated 31 per cent of the 465 new impact assessments as green, 41 per cent as amber, and 28 per cent as red.[5]

1.13 The coalition government has also introduced a ‘One-In, One-Out’ rule. The aim of this rule is to control the flow of new regulation by departments, encourage the use of regulation by departments only as a last resort, and reduce the net burden imposed on business and civil society organisations. The One-In, One-Out rule means that no new primary or secondary UK legislation which imposes costs on business or civil

[2] See Cabinet Office guidance on the Committee system at: http://www.cabinetoffice.gov.uk/resource-library/cabinet-committees-system-and-list-cabinet-committees

[3] There is no de minimis limit for impacts on business: if a proposal is likely to have any financial impact on business an impact assessment has to be completed whatever the size of those impacts and even if they are positive.

[4] http://regulatorypolicycommittee.independent.gov.uk/

[5] Regulatory Policy Committee Annual Report 2011 at: http://regulatorypolicycommittee.independent.gov.uk/wp-content/uploads/2012/03/RPC-REPORT-IMPROVING-REGULATION-March-2012-FINAL.pdf

society organisations (an “IN”) can be brought in without identifying existing regulation with an equivalent value in terms of net costs to business which can be removed (an “OUT”). Regulation which is required to implement EU or other international obligations is not within the scope of the rule except where the department's proposals go beyond EU obligations. The additional burden imposed by the wider proposals should then be taken into account and compensatory reductions found elsewhere.

1.14 In 2011 the coalition government launched the Red Tape Challenge to assess the continuing need for existing regulations. The Red Tape Challenge was designed to allow the public to help scrutinise government regulations and to identify and remove regulations which are outdated or ineffective, and replace them with more effective ways of achieving their goals. The Challenge is being run in a series of themes, such as equalities, health and safety, environment, and specific topics such as road transportation, energy, and medicines. Departmental proposals for reducing regulations are submitted to the Reducing Regulation Committee. Results are emerging from this exercise. For example, on Health and Safety the Government has accepted Professor Löfstedt's 2011 independent recommendations and as a result expects the 200 existing regulations to be reduced by a third and then to less than half by 2015, through combining, simplifying and reducing them. On environmental regulations, the government has announced that of 255 regulations, 132 will be improved, mainly through simplification or consolidation; 70 will be kept as they are, to uphold important environmental protections; and 53 obsolete regulations will be removed.[6]

Economic instruments and tax impact notes

1.15 Tax proposals are not covered by the regulatory impact assessment process but in December 2010, the coalition government committed to publishing 'Tax Information and Impact Notes' to give greater transparency to tax decision-making. This commitment succeeded the Labour government's practice of consulting on proposed budgetary changes through the Pre-Budget Report, and including in the Pre-Budget Report and Budget Reports tables which set out the environmental impact of budgetary proposals. The tables were introduced in response to a recommendation from the Environmental Audit Committee.

1.16 Tax information and impact notes are required for all substantive policy changes in tax and National Insurance contributions by primary and secondary legislation, but not for changes to rates, allowances and threshold changes, and other minor measures. They are published alongside the Budget, publication of draft legislation or final legislation, as appropriate. They are intended to provide a clear statement of the policy objective, impact on the Exchequer, the economy, individuals, businesses and civil society organisations, as well as any equality and other specific impact. They are also intended to allow interested parties to inform the Treasury's understanding of a

[6] http://www.redtapechallenge.cabinetoffice.gov.uk/2012/03/environment-rtc-announcement/

proposed change in policy and provide feedback on likely impacts.[7] By March 2012, 41 tax information and impact notes had been published covering a wide range of fiscal measures. They are available on the HM Revenue and Customs website.[8]

1.17 Tax information and impact notes are relatively short documents and are published when the detailed policy design is final or near final. They summarise the outcome of internal analyses and policy decisions, but do not contain detailed analysis of policy options. The notes therefore differ significantly from impact assessments and business cases which address alternative options. 'Economic instruments', such as the Carbon Price Floor, are not straightforward taxes or regulations and in practice departments determine what appraisal process to employ.

Expenditure processes and appraisal

1.18 Government decision-making regarding expenditure is determined at two main levels:

- Strategic decisions made periodically through the Spending Review process about the level of resources to be made available to individual departments;
- Decisions made within departments on individual programmes and projects, generally on the basis of appraisals and business cases.

1.19 Strategic spending decisions are subject to challenge within the government and Ministerial accountability to Parliament. The appraisal and challenge process for recent Spending Reviews has been designed individually for each exercise. The Treasury would expect strategic proposals and decisions to be informed by the Green Book guidance and appraisal approach. In Spending Review 2010 departments were encouraged to bring together evidence on cost benefits based on their appraisals, to support their initial bids for their future spending. They were also asked to rank and allocate their capital spend proposals using benefit-cost ratios. Spending proposals were subject to discussion and challenge before going to the Cabinet for high level spending decisions to be made. Spending Review decisions have not typically been accompanied by impact assessments.

1.20 Other strategic expenditure intentions can be announced without the completion of a business case or economic evaluation. Examples include the commitment to increase spending on foreign aid to meet the United Nations target of 0.7 per cent of gross domestic product; and the commitment to create the £1.4 billion Regional Growth Fund in June 2010. In the case of the Regional Growth Fund an impact assessment was subsequently produced in November 2011 alongside the decision to enlarge the Fund by £1 billion.

[7] http://www.hm-treasury.gov.uk/tax_policy_making_new_approach.htm

[8] http://www.hmrc.gov.uk/thelibrary/tiins.htm

1.21 Within the annual cash limits flowing from the Spending Review settlement and subsequently approved by parliament in departmental supply estimates, departments manage their use of resources subject to long-established rules regarding the need for Treasury review and approval of programmes and projects that exceed departments' approval limits or that are novel or contentious. Central guidance from the Treasury specifies the business case process that departments must follow when seeking Treasury approval for spending decisions on programmes or projects. Treasury guidance also addresses the committee structures departments should have in place for managing and monitoring their business, including the role of the new departmental boards.[9] All departments are expected to employ the recommended analytical and decision guidance in their own internal decision and review processes.

1.22 The coalition government has also introduced a new business plan process for Cabinet Office review and approval of departmental objectives and monitoring and publicly reporting departmental progress.[10]

1.23 The Treasury's guidance for business cases requires consideration of ‘five cases' for the programme or project (Figure 5).[11] The economic evaluation of costs and benefits is a core requirement for a business case, just as it is for impact assessments, but the business case process also requires consideration of wider impacts and delivery risks.

1.24 While all business cases above individual departmental spending limits are subject to review, those with costs of £1 billion or more or which are very high risk are generally reviewed by the Major Projects Review Group through a process operated jointly by Cabinet Office and HM Treasury. These proposals are required to follow Green Book guidance for analysis and business case guidance for planning, presentation and the decision process.

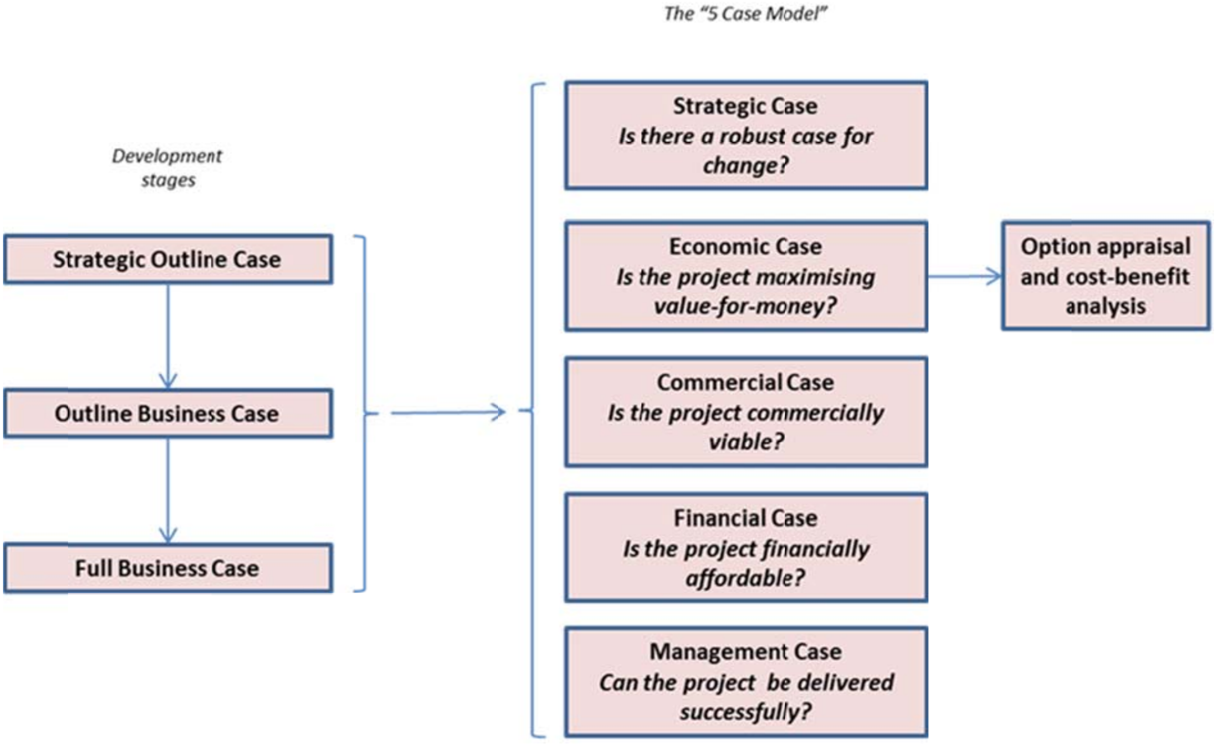
1.25 Unlike impact assessments, business cases are not routinely published, although some are. For example, business cases for major national infrastructure investments, such as the proposed HS2 rail scheme which is forecast to cost in total more than £30 billion, may be subject to extensive public consultation and critical analysis. However, many smaller business cases are processed internally within departments and are not published.

[9] HM Treasury have published two documents relating to corporate governance in central government departments - a Code of Good Practice, and an additional Code of Good Practice Guidance Note. See: http://www.hm-treasury.gov.uk/psr_governance_corporate.htm

[10] http://sd.defra.gov.uk/2012/03/mainstreaming-sustainable-development-in-policy-progress-review/

[11] http://www.hm-treasury.gov.uk/data_greenbook_business.htm

Figure 5: Business cases - the 'five case' model



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Source: National Audit Office, based on HMT 'Assessing Business Cases'

Impact assessment within the EU

1.26 The European Union (EU) also has an impact assessment process for appraising its draft proposals and regulations, which are for implementation by member states. The Secretariat General determines each year which proposals require impact assessments, following consideration by the Impact Assessment Board and the directorates concerned. In general impact assessments are produced for the most important Commission initiatives and those which will have the most far-reaching impacts. Impact assessments address administrative costs of the options considered and their economic, environmental and social impacts. The Impact Assessment Board reviews draft impact assessments produced by the relevant department within the Commission and gives recommendations and publishes an opinion on their quality.

1.27 Unlike in the UK, the EU impact assessment process is of the initial proposal and does not have to be updated as the proposals are amended. The European Parliament and the Council may assess the impacts of their own 'substantive' amendments to the Commission's proposals, and use the Commission's impact assessment as the starting point for their assessment work. But as Draft EU proposals and regulations may be subject to extensive negotiation over long periods of time and detailed aspects may be dealt with through the process of comitology,[12] they can be subject to substantial change before they are finalised. As a result, the impact assessment may not accurately reflect the final revised proposals. Individual member states' policy appraisal work is likely to inform the EU's impact assessment. But for the final proposal there may be little time for Member States to complete their own final impact assessments to evaluate the proposal's likely costs and benefits at a national level, as regulations may come into force soon after they are ratified.

Independent reviews of the policy making and appraisal process

1.28 There have been a number of recent reviews of the policy making and appraisal process at a strategic level. In April 2011, the Institute for Government published a suite of reports on policy making. These concluded that there were major weaknesses in the current approach and made various recommendations for a radically new approach within and across departments (Annex 1). In July 2011, the National Audit Office published a report on Option Appraisal. A key theme of this report was the scope to improve the quality of appraisals and to bring business cases and impact assessment processes together where they share a common purpose and in areas where each has strengths the other should learn from (Annex 2). In addition the British Chamber of Commerce has published a review of the regulatory impact assessment process in December 2011.[13]

1.29 Issues of potential interest to the Committee arising from these reports, and from our further consideration of the landscape, include the following:

a. Formal appraisal processes may not encompass all significant decisions across government. In particular, there remains a lack of clarity about the distinction between regulation and economic instruments. Departments may however decide for themselves to apply the processes when they see that as appropriate.

b. There is no central process to check and report that all policy decisions and significant policy changes have been subject to the appropriate options appraisal and impact assessment process. Some policy decisions and changes to draft legislation have not been supported by impact assessments. For example, no impact assessment was produced to accompany the 2011 decision not to recycle revenues from the CRC Energy Efficiency Scheme even though the revision would have significant impacts on business.[14]

c. There are significant differences between the three main appraisal processes. Impact assessments are published alongside government draft consultations

[12] Comitology is the process whereby responsibility for finalising detailed aspects of new proposals is delegated to the European Commission assisted by committees consisting of member state representatives.

[13] British Chamber of Commerce, Red Tape Challenged, December 2011

[14] National Audit Office, The CRC Energy Efficiency Scheme, March 2012, paragraph 2.15

and final proposals, and are subject to review by the Regulatory Policy Committee. Business cases, on the other hand, are often not published and consider a range of sensitive issues such as the extent of risk involved from a managerial and operational perspective. Tax information and impact notes, in contrast to both the impact assessment and business case processes, do not consider a range of options and are relatively limited in the extent of the information disclosed. Neither business cases nor tax information and impact notes have a requirement for independent external review, although business cases for major projects may be reviewed by the Major Projects Authority.

d. The impact assessment process and business case process can be difficult to apply to assessing the impact of wide-ranging changes to a policy landscape. For example, impact assessments of the costs and benefits of strategic measures such as the Climate Change Act 2008 require very high level appraisal, which may be informed by general findings from scientific research, international concerns over impacts, and by the potential for technological developments and the associated economic benefits they might bring.

e. The policy development process can be incremental, with strategic decisions taken early on in a policy development process and more detailed policy developed subsequently. Impact assessments of early strategic level decisions will be high level. Impact assessments of later decisions may not address the original alternatives. This can result in a policy measure developing from initial intentions and the final assessment of its net present value not being comparable with initial estimates for alternative options. Departments' review processes will need to consider whether there have been underlying changes which mean earlier decisions need to be revisited alongside do nothing alternatives before final decisions are taken.

f. The Regulatory Policy Committee’s remit does not extend to the coverage of all new regulation. This is because the better regulation process excludes non-regulatory proposals which have no direct impact on businesses, regulatory proposals put forward by regulators such as Ofcom or Ofgem, proposals with cost impacts on the public sector of less than £5 million, and proposals which involve minor amendments to existing regulations. The Better Regulation Executive's public database is of departments' Impact Assessments, and does not support analysis of the number of impact assessments which relate to the implementation of EU regulations, or the scale of the costs and benefits covered by the recorded impact assessments.

g. The Regulatory Policy Committee's role was created with a view to assessing regulatory costs on business. While it assesses impact assessments against the Better Regulation Executive's guidance, it has no specific role for examining other issues addressed within impact assessments, such as social and environmental impacts.

Part Two

Appraisal guidance and sustainable development

Introduction

2.1 This Part of the briefing sets out the guidance on appraisal and explores its central emphasis on cost-benefit analysis, approaches to monetisation of non-financial impacts, including environmental and sustainable development impacts, and other ways wider impacts may be taken into account.

Guidance on appraisal

2.2 There is both general government guidance on financial management and appraisal, in Managing Public Money and the Green Book, and guidance for the individual aspects of the decision making landscape, on impact assessments, business cases and the One-In, One-Out rule (Figure 6). The Green Book constitutes the authoritative source of appraisal guidance governing the valuation of social welfare. It is maintained by the Treasury, and has links to a variety of supplementary guidance. The impact assessment guidance and guidance on the One-In, One-Out process is maintained by the Better Regulation Executive in the Department for Business Innovation and Skills. Guidance on business cases and on tax is maintained by HM Treasury, and greening government commitments set out expectations in respect of sustainable procurement.

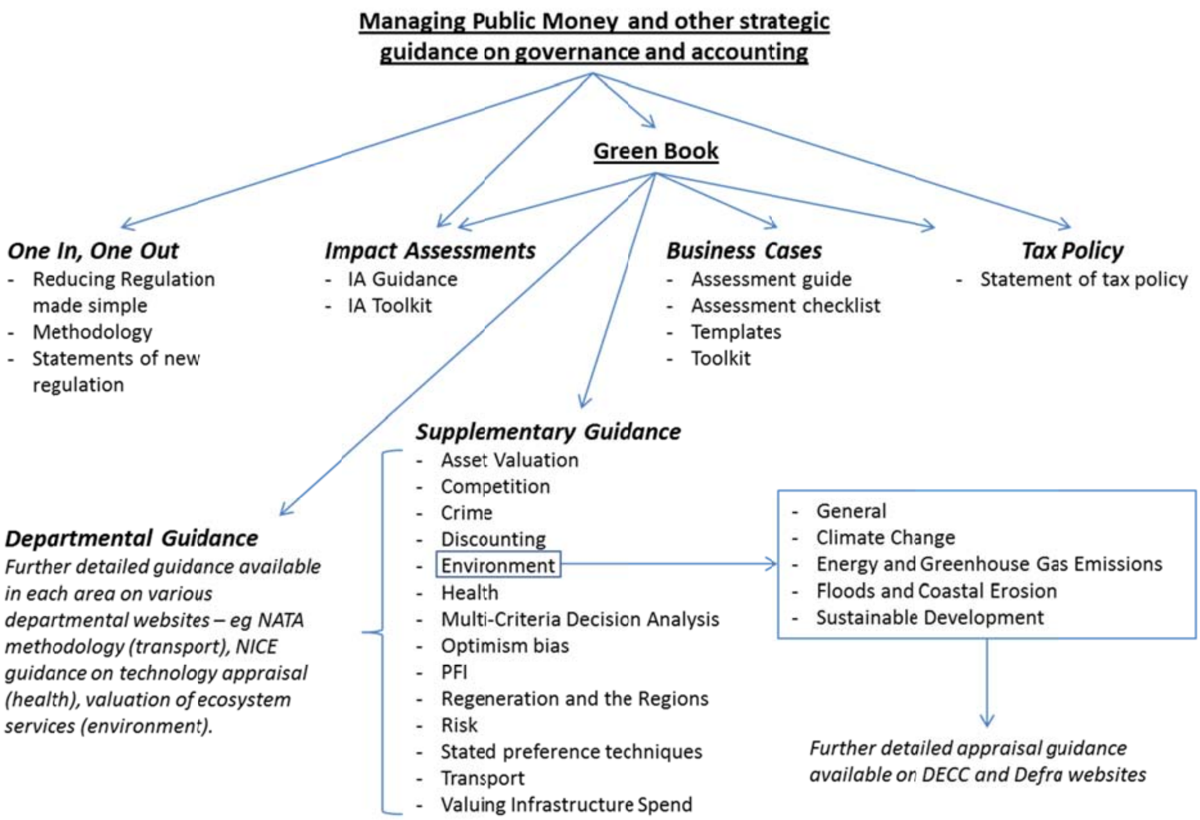
2.3 The impact assessment guidance was substantially revised in August 2011, and it now consists of two documents – the main guidance, which focuses on when to do an impact assessment and the strategic issues involved, and a toolkit which provides detailed advice on how to do an assessment. The new impact assessment proforma no longer includes ten specific impact tests to address wider impacts.[15] But the revised guidance discusses these areas and emphasises the need to consider them in appraisals,[16] and the new proforma still requires departments to disclose the impact of each option on carbon emissions.

[15] The specific impact tests covered: equality, small businesses, competition, justice, health and wellbeing, human rights, rural proofing, greenhouse gas emissions, wider environmental impacts, and sustainable development.

[16] Better Regulation Executive, Impact Assessment Guidance, August 2011

2.4 The current Green Book dates from 2003, with supplementary guidance added or amended more recently. Recent developments include new supplementary guidance on accounting for environmental impacts in policy appraisal, which was developed by the Department for Environment, Food and Rural Affairs (February 2012);[17] revised guidance from the Department of Energy and Climate Change on the valuation of energy use and carbon emissions in policy appraisal (October 2011);[18] and a discussion paper, developed by the Department for Work and Pensions, on an appraisal technique for using wellbeing measures to calculate the monetary value of non-market based goods and services, such as the value of volunteering (July 2011).[19]

Figure 6: Appraisal guidance



Source: National Audit Office

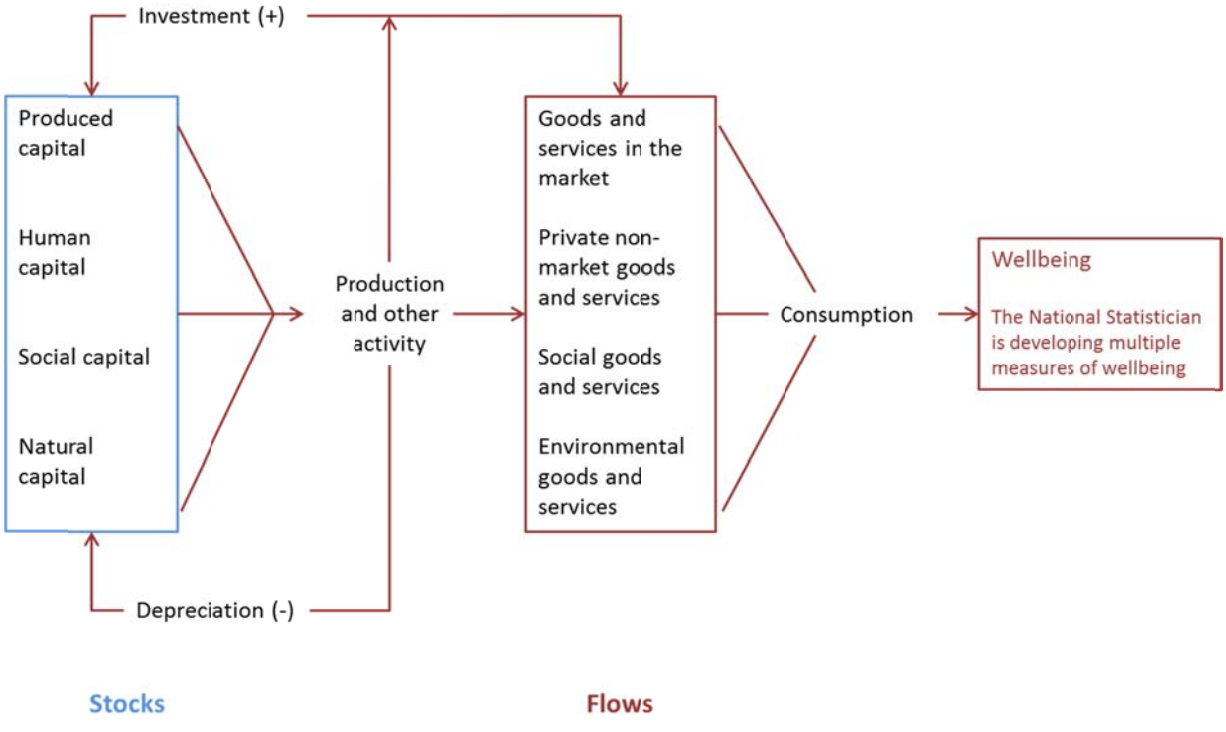
[17] See: http://www.hm-treasury.gov.uk/d/accounting_environmental_impacts.pdf

[18] See: http://www.decc.gov.uk/en/content/cms/emissions/valuation/valuation.aspx

[19] See: http://www.hm-treasury.gov.uk/data_greenbook_news.htm

2.5 The Treasury has indicated its intention to refresh the Green Book further. Developmental work underway includes work being led by the Social Impacts Taskforce[20] to improve the consistency with which social impacts are assessed across government, in order to improve the quality of policy development and advice given to decision-makers. The Taskforce has developed a conceptual framework to guide its work on understanding the relationships between the wider impacts of policies, their effects on the UK's underlying produced, human, social and natural capital, and implications for wellbeing (Figure 7).[21] The Department for Environment, Food and Rural Affairs has subsequently published a discussion paper on assessing and integrating social impacts and wellbeing into valuation and appraisal using multi-criteria analysis.[22] It is also working with the Department for Transport to develop new supplementary guidance on the valuation of air quality.

Figure 7: Social Impacts Taskforce's framework for identifying, understanding and capturing social impacts



Source: Social Impacts Taskforce, February 2011

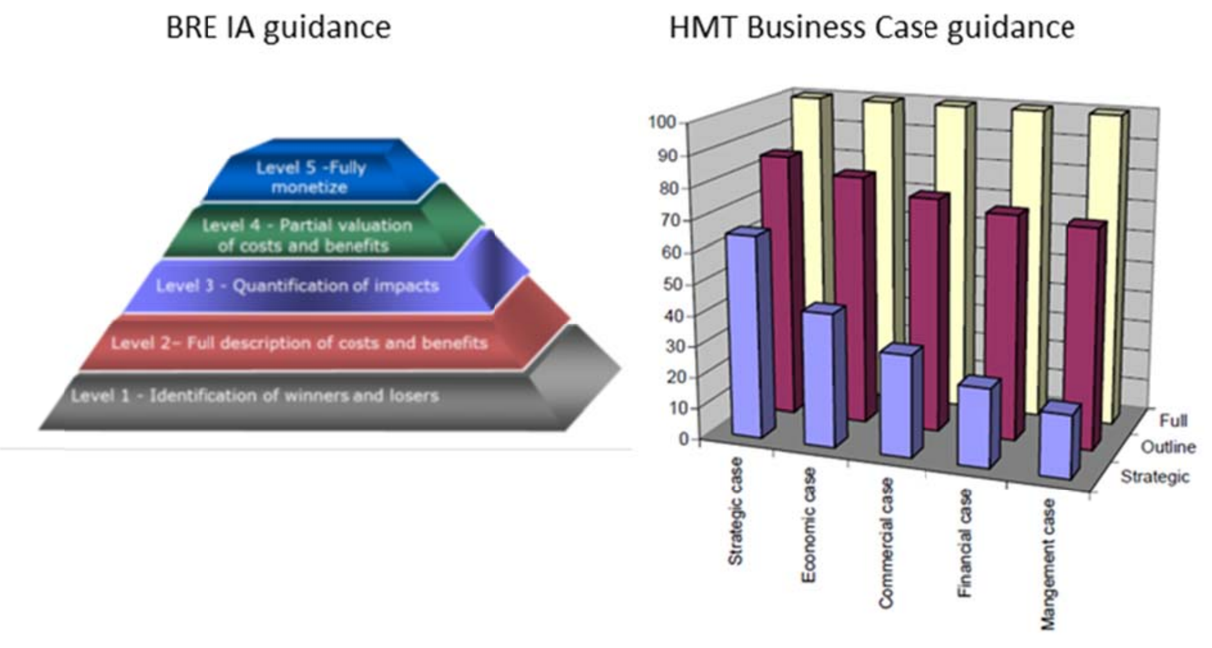
[20] The Social Impacts Taskforce, chaired by the Business Innovation and Skills department Chief Economist, was established to develop better assessments of the social impacts of policy in appraisal.

[21] Defra, Evidence and Analysis Paper 3, A framework for understanding the social impacts of policy and their effects on wellbeing, April 2011

[22] Defra, Evidence and Analysis Paper 5, Social Impacts and Wellbeing, December 2011

2.6 The Green Book and impact assessment guidance require departments to monetise the costs and benefits of each policy or project option in order to help choose between them. Some forms of impacts - particularly economic impacts - may be directly measurable in financial terms. Some impacts may be quantifiable in non-financial terms (for example, changes in greenhouse gas emissions) and a financial value placed upon them. A third category of impacts, such as impacts on biodiversity, may be difficult to monetise or quantify. Both the impact assessment and the business case guidance aspire to 100 per cent of costs and benefits being monetised in the final version of the appraisal (Figure 8), while recognising that there may be other relevant factors which cannot be financially quantified. The latest impact assessment guidance recognises that significant resources can be involved in monetising impacts, and that the effort invested should be proportionate to the likely scale of the impacts.

Figure 8: Stages in the monetisation of costs and benefits



Source: BRE Impact Assessment main guidance; HMT Business Case Assessment guidance

Cost-benefit analysis

2.7 The Green Book recommends the traditional cost benefit analysis approach as the preferred method of appraising social welfare, though it recognises that other related approaches may sometimes be appropriate. The latter include the benefit-cost ratio approach and the cost utility approach, both of which are also used in government.

- The traditional cost benefit analysis approach is based upon assessing costs and benefits over a defined period (eg twenty years) and discounting them. Netting off the costs against benefits produces a single net present value for each option, and the net present values of different options can then be compared. Other things being equal the option with the highest positive net present value would be selected as the preferred option.

- Benefit-cost ratio analysis is based on a similar approach of discounting costs and benefits. But instead of netting them off, the ratio of benefits divided by costs is calculated. The preferred option is the one which offers the highest ratio, so that for a given cost the project with the highest benefit is chosen. The ratio approach is used by the Department of Transport for assessing competing investment schemes and is particularly useful where welfare values have to to be considered against a budget constraint. In carrying out ratio analysis, considerable care needs to be taken that costs and benefits are classified on a consistent basis. Also, when comparing projects with different costs, it may be relevant to consider the scale of the net present value.

- Cost-utility analysis is not a clearly defined technique and is not recognised or recommended in the Green Book. It aims to monetise impacts to calculate net present values (as in the cost benefit analysis approach above), but uses one key parameter, which is not monetised, to rank the different policy options. For example, the effectiveness of different medical treatments may be compared by calculating the net cost against the benefit to the patient as measured in quality assured life years. The cost-utility approach is particularly appropriate where departments are facing non-financial statutory targets. For example in relation to plans to reduce carbon emissions, policy options are compared in terms of their cost-effectiveness in reducing carbon emissions, for example in marginal abatement cost curve analysis.

Monetising non-financial impacts

2.8 There are three main approaches to monetising non-financial impacts and some impacts may be monetised using elements of all three approaches:

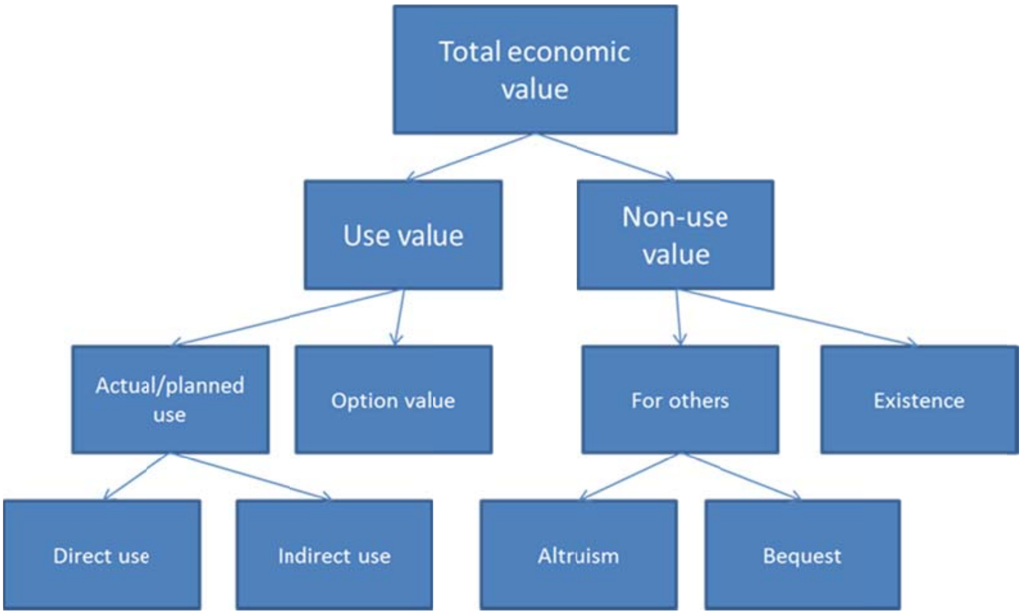
- **Preference based**: these approaches aim to elicit through questionnaires or observations the financial value which people are prepared to place on environmental and social goods ("willingness to pay") or how much they would need to be paid to accept negative impacts ("willingness to accept") . There are a variety of different methods and techniques which can be used within this overall approach.

- **Damage costs:** this approach aims to identify the costs which might arise from a failure to mitigate environmental and social impacts. For example, research carried out in 2004 under the government's Foresight programme revealed that - if no action were taken - the costs of flooding to the UK might rise to £27 billion a year by 2080.

- **Abatement costs**: this approach aims to identify the costs of avoiding impacts partially or completely. This might involve, for example, calculating the likely costs of building flood defences and taking other appropriate action to reduce future flooding.

2.9 The Green Book provides guidance on incorporating environmental and social impacts, focusing particularly on preference based approaches. It gives an overview of the different methods which can be used in this area, including revealed preference techniques, stated preference techniques and the 'life satisfaction approach'.[23] It also gives guidance on valuing time savings and health benefits. The Green Book supplementary guidance on Accounting for Environmental Impacts provides a conceptual framework for identifying use and non-use environmental impacts, direct and indirect, to provide the 'total economic value' of a policy (Figure 9). It provides step by step guidance on identifying impacts and how to apply valuation techniques to the different types of environmental impact that are part of the total economic value.

Figure 9: Total economic value



Source: 'Accounting for Environmental Impacts', HM Treasury Green Book

2.10 Using these techniques to obtain values for non-financial impacts often involves bespoke studies. Examples of such studies include the Department for Environment, Food and Rural Affairs' major UK National Ecosystem Assessment (2011) which aimed to monetise various ecosystem services and their contribution to the UK economy. Earlier studies have underpinned, for example, the initial setting of the

[23] The life satisfaction approach uses surveys of life satisfaction to elicit values for non-market goods.

Landfill Tax and the Aggregates Levy. In principle, monetised values established in research for one appraisal might be transferable to other appraisals ('transfer values'), but in practice great care needs to be taken in doing so as the circumstances in which these values are applied may be subtly but significantly different.

2.11 In addition to general guidance on monetisation techniques, some of the guidance includes specific values which can be used in relevant sections of any similar appraisal - such as the Department of Energy and Climate Change's guidance on the valuation of carbon emissions and the Department for Transport's valuations of certain kinds of transport impacts.

Non-financial approaches to valuation

2.12 Non-financial impacts are frequently of key importance in final policy decisions and are often poorly presented. The National Audit Office has noted that in impact assessments it reviewed, the preferred option was supported by quantitative cost-benefit analysis in only 23 out of 45 cases; and that, in the remaining cases, qualitative reasoning was a decisive factor. It also concluded that in 19 of the 45 cases either significant non-monetised costs or benefits had not been discussed or the discussion as a whole was inadequate.[24]

2.13 The Green Book and impact assessment guidance offer relatively little guidance on how to formally consider impacts where they cannot be monetised. They suggest departments may adopt critical success factors or multi-criteria analysis approaches:[25]

- The critical success factor approach amounts to a listing of all criteria relevant to a decision and a subjective scoring against each.
- Multi-criteria analysis takes this further by weighting the criteria against each other to produce a single overall score. Different options can then be ranked according to their scores.

2.14 The Department for Transport uses a critical success factor approach to present information on the economic, social, and environmental impacts of a transport investment proposal on a single sheet of paper in the form of an Appraisal Summary Table (Figure 10). This approach is intended to provide decision makers with a concise overview of impacts across the board. Where impacts can be financially quantified, economic values are included; where they cannot, impacts are ranked on a seven-point scale ranging from a strong adverse impact (-3) to a strong favourable impact (+3). The methodology has evolved over time since its introduction as the New Approach to Transport Appraisal (NATA) in 1998.

[24] NAO, Option Appraisal: making informed decisions in government, May 2011, paragraphs 2.17 to 2.18

[25] HMT, Green Book, paragraph 5.78

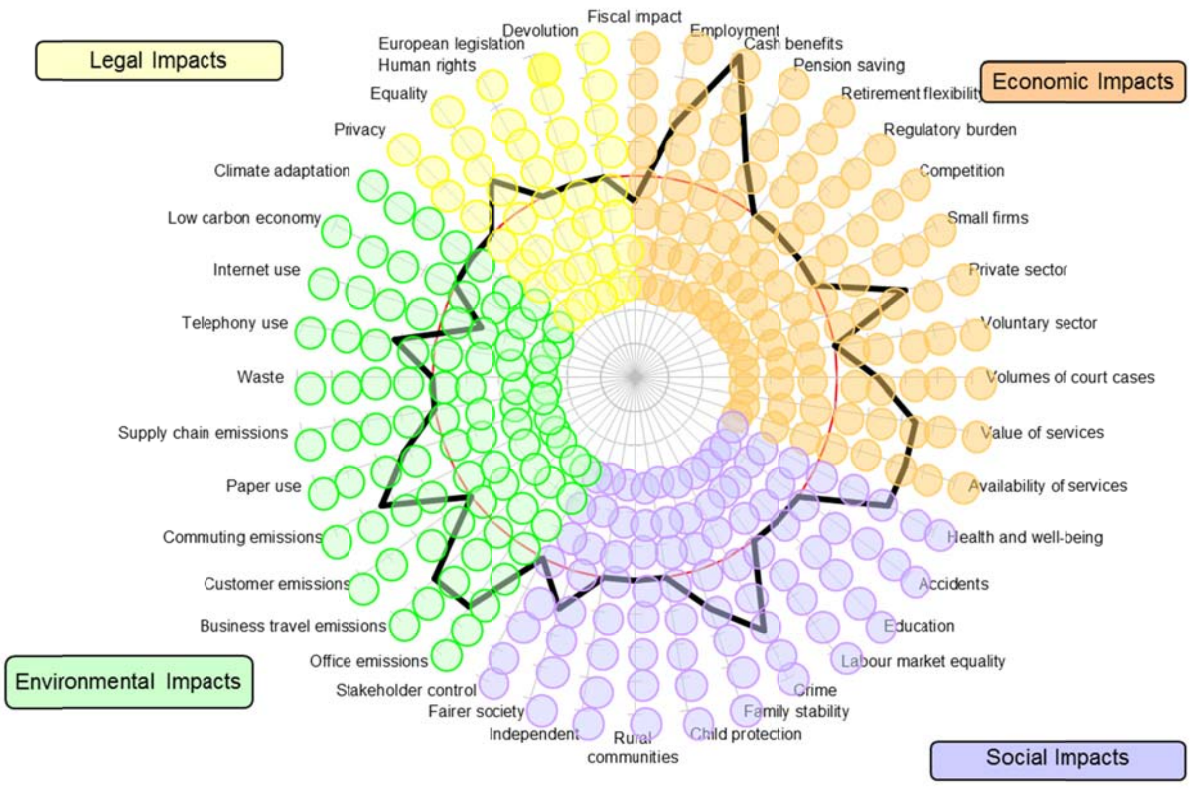
Figure 10: Department for Transport - Appraisal Summary Table

Impacts		Summary of key impacts	Assessment: Quantitative	Qualitative	Monetary £(NPV)	Distributional 7-pt scale/ vulnerable grp
Economy	Business users & transport providers		Value of journey time changes(£) Net journey time changes (£) 0-2 min / 2-5 min / > 5min			
	Reliability impact on Business users					
	Regeneration					
	Wider Impacts					
Environmental	Noise					
	Air Quality					
	Greenhouse gases		Change in non-traded carbon over 60y (CO2e) Change in traded carbon over 60y (CO2e)			
	Landscape					
	Townscape					
	Heritage of Historic resources					
	Biodiversity					
	Water Environment					
Social	Commuting and Other users		Value of journey time changes(£) Net journey time changes (£) 0-2 min / 2-5 min / > 5 min			
	Reliability impact on Commuting and Other users					
	Physical activity					
	Journey quality					
	Accidents					
	Security					
	Access to services					
	Affordability					
	Severance					
	Option values					
Public Accounts	Cost to Broad Transport Budget					
	Indirect Tax Revenues					

Source: Department for Transport webTAG website

2.15 Other Departments have also used a critical success factor approach. The Department for Work and Pensions have developed two tools - a policy evaluation tool for high-level impact assessment of policy initiatives as they are being developed, and a sustainability tool which includes more in-depth analysis. Individual impacts are scored and can be weighted to reflect their importance. For both tools, the results are summarised in a table and scores are fed into a diagrammatic analysis known as a sustainability web. Each radial line represents a distinct assessment criterion, with negative impacts recorded closer to the centre and positive ones further out (Figure 11). The aim is to enable decision makers to be able to see at a glance the full range of impacts involved and to compare easily different policy options. This tool represents a development of the 'Stretching the Web' guidance previously issued by the Department for Environment, Food and Rural Affairs and it is now being shared across Whitehall through the sustainable development cross-Whitehall working group.

Figure 11: Department for Work and Pensions example of a 'web' diagram for representing impacts



Source: Department for Work and Pensions

2.17 As noted in paragraph 2.5, the Department for Environment, Food and Rural Affairs has also published a review of multi-criteria techniques to help assess and integrate social impacts and wellbeing into valuation and appraisal. The review builds on its paper on understanding the social impacts of policy and their effects on wellbeing, and on the work of the Social Impacts Taskforce. It is intended to help integrate a greater range of quantitative and qualitative non-monetary evidence with monetised values in order to develop greater understanding of social impacts and wellbeing, and enhance department's ability to take more account of them in the design and evaluation of government policy.

2.18 The National Audit Office has found little evidence of systemic, structured discussions of non-monetised impacts in its review of Impact Assessments, but qualitative analysis was handled better in the business cases reviewed.[26] Structured attempts to specify non-financial costs and benefits can support more structured efforts to mitigate them or realise the benefits and monitor outcome. The National Audit Office recommended introducing a requirement for a structured consideration of qualitative factors on a common basis with quantitative analysis, consistently applied across options, and extending associated practical guidance.

Statutory targets and environmental limits

2.19 Giving a monetary value to non-financial impacts or using appraisal summary tables allows policy makers to see and weigh up financial and non-financial impacts. However there are areas of policy making where at a policy level it has already been determined that targets need to be met or limits set on the extent to which a natural resource can be used, for example because breaching a limit would destroy or radically alter the related ecosystems. In some areas the existence of environmental limits has been extensively researched and as a result targets or limits have been agreed, such as the setting of UK Carbon Budgets or EU fishing quotas to limit the maximum size of catch allowed to maintain fish stocks.

2.20 Statutory targets and environmental limits can fundamentally change the nature of the decision-making process. When governments are committed to meeting statutory targets, decision-makers will compare the costs and benefits of options that meet the targets and may compare their relative cost-effectiveness and the extent to which they contribute to meeting the target.

[26] National Audit Office, Option Appraisal in Central Government, May 2011 (see Annex 2)

2.21 Where there are environmental limits it is important for decision-makers to consider the individual impact of a policy and cumulative impacts from all policies and proposals. In 2010, the Government Economic Service recognised that more needed to be done to account for thresholds in environmental systems, irreversible impacts, and inter-generational impacts. It explored the potential to improve cost benefit analysis by taking more account of important risks that do not have a monetary value and by developing some form of 'asset check' to account for large, irreversible impacts on assets that are essential to social and economic activity.

2.22 In the Natural Environment White Paper (June 2011), the government committed itself to creating a Natural Capital Committee to provide independent expert advice on the extent to which natural assets are being used unsustainably and on how the government should prioritise action to protect and improve natural capital. The Committee reports to the Economic Affairs Committee, and met for the first time in May 2012. The White Paper also included a commitment to take forward a scoping study to develop a natural capital asset check.

Issues associated with addressing sustainable development within appraisal

2.23 The National Audit Office considers that the structured presentation of costs and benefits on a comparable basis and in monetary terms helps decision-making and the management of budgets across programmes. Valuing non-financial costs and benefits can be difficult and the National Audit Office has previously noted there is scope to improve levels of monetisation by promoting its use and promulgating good practice, for example, by extending libraries of techniques and cross-departmental contacts. Key areas of difficulty in bringing sustainable development issues into appraisal which may be of interest to the Committee include the following:

a. It can be difficult to quantify the full range of impacts (both positive and negative) associated with different policy options, because of the complex modelling that would be required. For example the Department of Energy and Climate Change has noted that its cost effectiveness estimates in the Carbon Plan may not reflect impacts such as competitiveness, distributional impacts and impacts on other environmental and social considerations.[27] The Department for Work and Pensions has noted it can model labour supply impacts from the Universal Credit but not wider dynamic impacts (Figure 12).[28]

[27] Department of Energy and Climate Change, Carbon Plan, Box B5, Limitations of Marginal Abatement Cost (MAC) Analysis, http://www.decc.gov.uk/assets/decc/11/tackling-climate-change/carbon-plan/3702-the-carbon-plan-delivering-our-low-carbon-future.pdf

[28] Department for Work and Pensions, Universal Credit Impact Assessment, paragraph 89 (October 2011). See: http://www.dwp.gov.uk/docs/universal-credit-wr2011-ia.pdf

Figure 12: Universal Credit (Department for Work and Pensions)

"Universal Credit represents a fundamental and structural change to the welfare system. As a result, it is not possible to reach definitive conclusions about the likely scale of the labour supply impacts of the measure using analysis and evidence in the current system. Traditional labour supply modelling is helpful in understanding the impact of small changes in financial incentives within the confines of the existing tax and benefit system, but cannot account for many of the other factors associated with this reform that are likely to elicit a dynamic response."

Source: DWP, Universal Credit impact assessment, October 2011, paragraph 89

b. Where it is difficult to quantify all costs and benefits associated with different options, appraisals may focus only on the differences between options and not attempt to quantify those impacts which are likely to remain the same. This may be a proportionate approach when impacts not assessed apply equally to all options, including the "do nothing" option. But it risks failing to understand the absolute scale of impacts.

c. Some impacts, especially some kinds of environmental impacts such as global warming, can occur over many decades or even centuries. The Green Book guidance requires the use of discounting to ensure appraisals are systematic and transparent about the trade-off between costs and value obtained in the short-term against long-term impacts. Most appraisals quantify the financial value of impacts over only 20 or 30 years. Green Book guidance allows for stepped reductions from the 3.5 per cent recommended discount rate for longer term impacts, with these reductions applying for costs and benefits which are 40 years or more in the future. In practice this discounting reduces the impact on the net present value of the costs and benefits for people in future generations. The Treasury has determined the rate of discounting that should be applied, which has remained unchanged since 2003.

d. Complex modelling and extensive assumptions are often required to evaluate both the 'business-as-usual' and the 'do nothing' reference case and the different policy options being considered. Such modelling relies on assumptions of relationships between economic variables and actions taken and involves a degree of uncertainty, flowing from the strength of the evidential basis for these assumptions. Previous NAO work has highlighted how uncertain complex government modelling can be. For example, the central projection of UK carbon emissions that informed the 2006 Climate Change Programme Review was outside the range of feasible scenarios anticipated in 2000.[29]

[29] National Audit Office, Climate Change Projections, December 2006

e. Current valuation approaches can only assess the impact of *marginal* changes in impacts rather than step changes, and to that extent they may understate the scale of potential impacts. For example, in land use planning the impact of many individual developments may result at some point in a further development having a major adverse impact on biodiversity.

f. Preference based approaches for monetising non-financial impacts are methodologically complex for environmental changes, which may have very long-term impacts, and indirect impacts which are complex to understand. Preference values expressed will be greatly affected by the method of their collection including sampling. For example, different societies and different sub-sets of a society may value impacts very differently; preferences may reflect short-term priorities rather than being informed by a full understanding of the nature of future impacts; and preferences may be influenced by external events.

g. The degree of risk and scientific uncertainty involved in forecasting future impacts can be very high. In the context of adaptation to climate change, for example, the Department for the Environment Food and Rural Affairs have suggested adopting a 'Real Options Approach' based on a staged response which does not preclude future options to mitigate more extreme impacts.[30]

[30] Department for Environment, Food and Rural Affairs, Accounting for the effects of Climate Change, 2009

Annex One

Institute of Government findings and recommendations

In April 2011, the Institute of Government published a suite of three reports relating to policy making - a supporting working paper ('System Stewardship'), an evidence and analysis report ('Policy Making in the Real World'), and a conclusions and recommendations report ('Making Policy Better'). The key findings of the two main reports are briefly summarised below.

The Institute drew on a range of sources including a literature review; interviews with 50 senior civil servants and 20 former ministers; an analysis of 60 policy evaluations from three departments; a survey of members of the Political Studies Association; and a series of policy success seminars.

Policy making in the real world (findings)

- Models of policy making are unrealistic and attempts to improve them have failed to take account of the role of ministers.
- Structured policy cycles are divorced from reality. In the real world, policy problems and policy solutions frequently emerge together, rather than one after another.
- Current processes greatly underestimate the value of policy design and market testing.
- Current guidance presents policies as discrete interventions to tackle specific problems. But the effects of interventions may be complex, wide-ranging and unintended, and it is unlikely that impacts may be measurable and attributable.
- A low priority is placed on evaluation and lessons often do not feed back into policy design or problem formulation.
- Efforts to promote innovation have not addressed many of the systemic barriers that exist.
- Organisational and structural changes to promote better policy making have been incoherent and incomplete.
- Existing approaches to best practice in policy making neglect ‘politics’ or treat it as something to be managed.
- Ministers may not allow a sufficient degree of challenge to their proposals, and civil servants may try to manage ministerial expectations.

Making policy better (key recommendations)

Quality of appraisals and responsiveness to ministerial priorities

- The appointment within each department of a ‘Policy Director’, reporting directly to the permanent secretary, to plan, commission and challenge internal policy work on behalf of ministers, review the current ‘stock’ of policy, and develop the department’s policy capacity.
- An extension of existing Accounting Officer responsibilities to cover due policy process, based on the policy fundamentals outlined above.
- Streamlined ‘policy assessments’ to replace existing impact assessments and business cases. These assessments would be available for public scrutiny, and officials would be personally accountable to departmental select committees for their quality.
- A greater role for the centre in overseeing the quality of policy making through the creation of a senior Head of Policy Effectiveness, who will also ensure rigorous and independent evaluation of government policies, and commission lessons learned exercises for major failures of policy process.

The relationships between civil servants and ministers

- Greater clarity from ministers on their high-level policy goals; and greater clarity from ministers and civil service leaders on the value both parties can bring to the policy process.
- Engaging ministers early in the policy process, well before options are identified, and finding new ways to create space for challenging discussions through internal tactics and by opening out the policy process. Departments should work together to produce shared analysis to allow ministers to focus on political choices.

Knowledge deficits and the need for new skills and behaviours in a decentralised world

- Better development of the skills of policy teams within departments, including more emphasis on policy design, innovation and influencing.
- Changes to incentives to retain internal expertise and to make more use of external expertise in policy making. Departments should be able to access the necessary expertise at ‘one degree of separation’.

Culture of the civil service: system stewardship rather than top-down management

- Whitehall policy makers need to reconceive their role increasingly as one of creating the conditions for others to deal with policy problems using innovative and adaptive approaches.
- Incentives need to reward those who energetically search out experience and ideas, network, facilitate and understand the systems within which they operate.

Annex Two

NAO Option Appraisal findings and recommendations

In May 2011, the National Audit Office published a review of option appraisal in central government. This was based on interviews with departmental Chief Economists, a survey of departmental policy staff, and detailed analysis of impact assessments and business cases. The review addressed the business case and impact assessment processes for option appraisal. Its key findings and conclusions are briefly summarised below.

Key findings

Established systems for option appraisal seek to promote good decision-making

Central guidance on cost-benefit analysis is thorough, and there are established systems to make sure that policy, regulation and expenditure projects are appraised. Many departments supplemented central guidance with material relevant to their sector. The quality of the appraisals varied demonstrating the need to sharpen the requirements for completing appraisals and tighten management of its application, to secure full value from the process. Both processes provide for the depth of analysis to be ‘proportionate’ to the significance of the decision. The challenge has been to define ‘proportionate’ logically and in a well-informed way: the central guidance does not cover this issue well.

Management of the appraisal processes by departments

Good planning helps to integrate appraisals into the decision-making process. Many departments had no standard process across their organisation to manage the development of Impact Assessments, but those that had such a process produced, on average, stronger appraisals. Good planning draws on scheduling and helps assign suitable appraisal resources and promotes a better programmatic overview.

Quality assurance processes are well established across government but they do not guarantee appraisal quality. Departments have different assurance processes. Strong external challenge and transparency were motivators for staff to improve the quality of appraisal. There was no management information on the initial quality of appraisals. Retrospective review of appraisals in one department had helped secure increased quality over the years.

Business cases and Impact Assessments, once produced, have not been used to manage the delivery of benefits and manage costs against original expectations. There has been a lack of post-implementation reviews or evaluations.

There are differences between the two appraisal systems in the timing, the precise analyses required, the format of appraisal documents and the delegation arrangements. Such differences reflect the historical development of regulation and expenditure control. Departments' staff did not have a full appreciation of existing guidance and requirements. Unnecessary differences between appraisal processes will incur extra cost in maintaining guidance, training staff and enforcing compliance and likely reduce the quality of appraisals overall.

Conclusions

There is scope to improve the quality of appraisals in a proportionate way, and increase their contribution to more cost-effective outcomes.

Improvements could be driven by:

- extending publication and external oversight of economic appraisals from Impact Assessments to business cases;
- departments adopting more structured quality assurance arrangements;
- introducing a proportionate process to limit Impact Assessment effort on low value appraisal to help focus effort where it is needed;
- checking that the cost and benefit information in appraisals is used as a basis for monitoring and managing the implementation of government interventions; and
- creating proportionate measures to mandate valuation or follow-up, in the way that sunset clauses are intended to operate for regulation

Central guidance on appraisal could be improved by:

- Clearer specification of what ‘proportionate’ appraisal effort means for option development, monetisation, and portfolio management. The specification should provide clear advice on areas where there is less discretion due to absolute limits (such as environmental or carbon limits).
- Improving levels of monetisation by promoting their use and promulgate good practice, for example, by extending libraries of techniques and cross-departmental contacts.
- Introducing a requirement for a structured consideration of qualitative factors on a common basis with quantitative analysis which is consistently applied across options, and extending associated practical guidance.
- Developing a requirement to create an explicit ‘logic model’, setting out the contributions of all factors to the subject of the appraisal, allowing the contribution of qualitative factors to be set in context.

Differences in approach between business cases and Impact Assessment, despite them both deriving from the Green Book, have obscured their underlying common purpose. The Treasury, the Better Regulation Executive and departments should:

- bring Business Case and Impact Assessment processes together where they share a common purpose (e.g. in economic appraisal);
- align processes drawing on their respective strengths (e.g. consideration of risk in business cases; transparency and challenge in Impact Assessment);
- bring together design of the Business Case and Impact Assessment processes to ensure consistent process design;
- and longer term they should integrate the oversight and management of the economic element of business case and Impact Assessment processes to support consistent decision-making and a standardised approach.

National Audit Office

This report has been printed on Consort 155

Design and Production by
NAO Communications
DP Ref: 009923-001 | Printed by: Precision printing