



National Audit Office

Paper

by the National Audit Office

Better Regulation Executive

Using alternatives to regulation
to achieve policy objectives

JUNE 2014

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Amyas Morse, is an Officer of the House of Commons and leads the NAO, which employs some 820 employees. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of £1.1 billion in 2013.

Contents

Summary 4

Part One

Introduction 8

Part Two

Alternatives to regulation 12

Part Three

Consideration of alternatives in the
policy development process 19

Part Four

Where efforts might be focused to
generate further alternatives 22

Methodology 26

The National Audit Office study team consisted of:
George Crockford, Matthew Fright, Charlie Gluckman, Louise Sumner and Baljinder Virk, under the direction of Alex Scharaschkin.

This report can be found on the National Audit Office website at www.nao.org.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Enquiries: www.nao.org.uk/contact-us

Website: www.nao.org.uk

Twitter: @NAOorguk

Links to external websites were valid at the time of publication of this report. The National Audit Office is not responsible for the future validity of the links.

Summary

1 Government can achieve its policy objectives by using taxpayer's money, or through a range of non-spending interventions, including regulation. Regulation aims to set rules to protect and benefit people, businesses and the environment, stabilising markets and addressing market failures to support economic growth. Regulation can also create costs for businesses, the third and the public sectors. It can, if overused, poorly designed or implemented, stifle competitiveness and growth. The government's Principles of Regulation see (Figure 1 on page 10) encourage departments to consider alternatives to regulation, and say that rule-based approaches should be a last resort.

2 The government wants to continue to reduce regulation. Departments must reduce the cost to business of regulation and focus regulation on where it adds the most value. Our previous work in this area¹ found that doing so needs arrangements for managing the flow of regulation. This is similar to the arrangements needed for managing taxpayer's money.

3 Alternatives to regulation include information and education, market-based structures, self-regulation and co-regulation. In addition, existing policies can be improved, without further regulation, using techniques such as behavioural insight or changing enforcement practices to improve compliance. Such approaches may be better or worse for business and the economy than an equivalent regulatory measure

4 This paper builds on our work to understand the government's actions to reduce rule-based regulation when it needs to intervene in markets to meet policy goals. We sought to understand what affects departments' use of alternatives to regulation and to learn lessons that can enhance their use across government. It forms the basis for further NAO work on using regulation to meet policy objectives.

¹ Comptroller and Auditor General, *Submission of evidence: controls on regulation*, National Audit Office, September 2012.

Findings

5 Departments have used alternative approaches to regulation. There are examples where information and education have helped to improve existing regulation and reduced the need for regulatory intervention. Industry sometimes sets out its own standards rather than having the government impose regulation.

6 There are incentives and barriers to departments considering alternatives to regulation. Incentives include alternatives to regulation being out of scope of both the 'One-in, Two-out' rule and scrutiny by the Regulatory Policy Committee. Barriers include a perception that regulation shows decisive action; an aversion to risk; poor knowledge of alternatives; and limited resource.

7 Few government departments use the full range of evidence available to develop alternatives. There are many policy areas in which government intervenes where regulation was never considered. These interventions are not labelled 'alternatives to regulation', but could provide generalisable lessons. Few of the policy officials we met knew what an 'alternative' was. This makes it harder to know what evidence they should be drawing on. When government has used alternatives it has done little to assess their success and to learn lessons for future policy development.

8 The effectiveness of alternative approaches varies by case and circumstance, and alternatives don't always work. For example, a rules-based approach may be appropriate for addressing conflict between government and industry objectives. Self-regulation may work better when the objectives of industry are closely aligned with governments. Policymakers need a good understanding of the factors that help the successful use of alternatives.

9 Policymakers need to consider alternatives early in policymaking. The minister is the overall decision-maker in policymaking and his or her buy-in is a critical factor in the success of alternatives. Getting ministers engaged requires discussion of alternatives at the earliest stages of policymaking. This means early engagement with stakeholder groups and using the department's analytical skills early on. Starting early in the process reduces the chances a preferred option is identified before alternatives are explored. A good quality consultation stage can also improve the appraisal of alternatives. Departments should ensure that the impact assessment properly assesses the costs and benefits of a range of policy options when entering consultation.

10 The lack of formal appraisal requirements for alternatives creates risks. A light touch approach to appraising alternatives can lead to risks, such as: missing the impact on competition; creating more burden than the rules-based approach to regulation; or not maximising benefits over costs. The lack of formal appraisals also reduces the information for departments to learn from.

Conclusion

11 There are some good examples across government of alternatives to regulation to achieve policy objectives. Centrally, there should be greater sharing of reviews of alternatives. This should help departments to overcome the perceived barriers to considering alternatives and to start development early on. Also to ensure that potential alternatives are not ruled out for lack of early consideration in decision-making processes. Departments should provide a stronger push for alternatives as they understand best which of its policy areas are most suitable for alternative approaches.

Matters for consideration

To ensure early consideration of alternatives

12 Key internal stakeholders should be involved at the early stages of policymaking. Internal stakeholders such as policymakers, better regulation teams, behavioural economists, economists, lawyers and social researchers should work together from the outset of policy development. Early engagement should encourage discussion of a wider range of options for achieving policy objectives.

13 There is a need for early and ongoing engagement with external stakeholders. Many of the examples of alternative approaches point to the need for early engagement with business, industry, the third sector and citizens. This should be done with a wide range of stakeholders early on, and continue through policy development, to review the success of interventions. This can be done outside of, or alongside, the formal consultation process.

To overcome perceived barriers to using alternatives

14 A stronger understanding of the factors that increase the success of alternatives is needed. Government needs to articulate more clearly what alternatives to regulation are, how they should be developed and implemented, and when they work best. This evidence may give policymakers and ministers more confidence to take alternative approaches to achieving policy objectives.

15 More evaluation of alternatives to regulation would help to better understand the impact and effectiveness of different policy approaches. Our prior reports on impact assessments found that relatively few post-implementation reviews were conducted. Providing a documented evidence base would make evaluation easier to perform and help hold departments to account. Stakeholders would understand more clearly the costs and benefits of the approach being proposed even if it is non-regulatory.

16 More evaluation of interventions not explicitly labelled ‘alternatives to regulation’ could provide greater insight. Government has intervened where the use of regulation was never considered. These interventions provide insights into the development of alternatives. Departments and the Better Regulation Executive could do more to draw out lessons for future policy development.

To improve the policymaking process

17 The Better Regulation Executive should continue working with department to inform policymakers about how alternatives to regulation should be considered during policy development. Sharing examples, and understanding where alternatives worked, may address some of the concerns and barriers. The Better Regulation Executive is working on information that will support policymakers early on in option development which should raise awareness. Departments will need to work with the Better Regulation Executive to disseminate this to policymakers.

Part One

Introduction

The government's approach to regulation and alternatives

1.1 The government can achieve its policy objectives by using taxpayers' money or through a range of non-spending interventions, including regulation. Regulation sets rules that protect and benefit people, businesses and the environment. Regulation can stabilise markets and address market failures to support economic growth. Regulation can also create costs for businesses, the third and the public sectors. It can, if overused, poorly designed or implemented, stifle competitiveness and growth.

1.2 The previous government developed a regulatory reform agenda as part of its efforts to create the conditions for business success. Its focus was on 'better' regulation, based on five principles: proportionate, accountable, consistent, transparent and targeted. It also placed emphasis on improving the regulatory and policymaking framework.

1.3 The previous government put in place the following initiatives as part of its efforts to reform regulation:

- In 1999, it introduced a requirement for departments to prepare impact assessments when considering policies which imposed new regulatory burdens. Impact assessments remain a key part of the regulatory process.
- The Administrative Burdens Reduction Programme was introduced in 2005. This five-year programme, delivered by 19 departments and regulators, was designed to reduce the net administrative cost to business of complying with regulation by 25 per cent.
- The government conducted a number of reviews of individual regulators to assess them against their compliance with the principles of better regulation. They were also assessed against the characteristics of effective sanctions, as defined by the Hampton report and the Macrory review.^{2,3} The purpose was to encourage regulators to follow best practice and to keep improving.
- The government emphasised the use of these initiatives in improving regulatory policymaking at EU level.
- The government established the Regulatory Policy Committee in 2009 to provide independent and expert scrutiny of regulations.

² Sir Phillip Hampton, *Reducing administrative burdens: effective inspection and enforcement*, 2005.

³ Professor Macrory, *Macrory Review of Regulatory Penalties*, 2005.

Coalition government's approach

1.4 Reducing regulation is one of the coalition government's key commitments. It committed to reducing the burden of regulation on business and ending the culture of tick-box regulation, and is achieving this by:

- Introducing the 'One-In, One-Out' rule in January 2011 to control the burden of new domestic regulation. In January 2013, this was increased to a 'One-In, Two-Out' rule under which departments must find two pounds of saving for every pound of estimated extra cost to business of new regulations.
- Extending the role of the Regulatory Policy Committee, to provide independent and external scrutiny of the evidence base for regulatory changes.
- Introducing sunset or review clauses for all new domestic regulations, to ensure that regulations are regularly reviewed.
- Introducing the 'Red Tape Challenge' programme, to review the stock of domestic regulation.
- Running a series of sector-focused reviews of enforcement through the Focus on Enforcement initiative. This examines how order is enforced from the viewpoint of a company, and aims to identify improvements.
- The Primary Authority scheme, legally binding agreements between local authorities and businesses, provides a single point of contact and assured advice for companies operating across authority boundaries.
- Starting a Business Taskforce to look at the impact of EU recommendations on British businesses. The Business Taskforce reported in October 2013.

1.5 Developing alternatives to regulation is another strand of this work to reduce the burden on businesses. The goal is to consider different ways of bringing about the change government wants to deliver. So government uses the most effective tool to achieve policy objectives, reduce burdens and bureaucracy and harness activity from third parties (e.g. consumers and businesses).

1.6 The government wants regulation to be considered only as a last resort, and has introduced and strengthened incentives for departments not to regulate and to consider alternatives.

1.7 'Alternatives' can mean putting in place a direct alternative to regulation such as providing education and information, or finding alternative models of regulation, such as self-regulation or co-regulation. These are discussed further in Part Two.

1.8 Sometimes an alternative can mean not implementing anything new, but clarifying existing regulations, or enforcing regulations more effectively.

Roles and responsibilities

1.9 The Department for Business, Innovation & Skills (BIS) leads on regulatory reform across government. Behind its work sits the government's three general principles of regulation, which act as an overarching guide for BIS's work with other departments (**Figure 1**). Encouraging the use of alternatives is a core element of the principles.

1.10 Responsibility for developing individual regulations, or their alternatives, rests with individual departments. For regulatory proposals, departments work within a set of requirements – the Better Regulation Framework.⁴ These rules help translate the government's principles of regulation into practice. Departments have a minister who is responsible for their department's performance on better regulation. Supporting the minister are senior officials, acting as Board Level Champions, and normally staff based in a Better Regulation Unit (BRU).

1.11 Draft regulatory proposals are submitted to the Reducing Regulation Committee (RRC), a subcommittee of the Cabinet which considers whether or not to proceed with the proposal. Just before, the appraisal supporting the proposal is reviewed by an independent committee, the Regulatory Policy Committee (RPC) who assess the quality of the evidence presented. This includes the consideration of alternatives to regulation.

Figure 1 Principles of Regulation

General Principles

The government will regulate to achieve its policy objectives only:

- 1 Having demonstrated that satisfactory outcomes cannot be achieved by alternative, self-regulatory or non-regulatory approaches.
- 2 Where analysis of the costs and benefits demonstrates that the regulatory approach is superior by a clear margin to alternative, self-regulatory or non-regulatory approaches.
- 3 Where the regulation and the enforcement framework can be implemented in a fashion which is demonstrably proportionate; accountable; consistent; transparent; and targeted.
- 4 There will be a general presumption that regulation should not impose costs and obligations on business, social enterprises, individuals and community groups unless a robust and compelling case has been made.
- 5 The government will adopt a One-in, One-out approach (now a One-in, Two-out approach).

Source: Available at: www.gov.uk/government/publications/better-regulation-framework-manual

4 Available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf

Scope of this paper

1.12 This paper explores the alternatives available to policymakers, the extent these are used, and the strength of incentives and barriers to using alternatives. This report forms the basis for further NAO work on the use of regulation to achieve policy objectives.

These issues are explored across three areas, including:

- the range of alternatives available;
- the policy development process; and
- the use of alternatives and the strength of incentives.

Part Two

Alternatives to regulation

2.1 This part sets out the various alternatives to regulation available to policymakers, the advantages and risks of different approaches, and examples of how they are being used across government. **Figure 2** shows a spectrum of the interventions available.

2.2 Alternatives to rule-based regulation are more flexible than a rule-based approach, since they do not require setting the rules out in legislation which then takes more time and effort to develop and change. When policymakers choose not to take a rule-based approach the two broad categories they can consider are: alternatives to regulation; and alternative models of regulation.

Alternatives to regulation include:

- no new intervention/do nothing;
- information and education; and
- incentive/market-based structures.

Alternatives models of regulation:

- self-regulation;
- goals-based regulation; and
- co-regulation.

Figure 2
Spectrum of interventions



Source: National Audit Office

Alternatives to regulation

No new intervention/do nothing

2.3 It is important to note that alternatives to regulation are unlikely to work at nil cost for businesses and citizens. The Department for Business, Innovation & Skills (BIS) recognises that both regulation and its alternatives will usually bring costs as well as generate benefits. When problems are identified or new policy ideas are formulated, the first consideration should be whether the government needs to act.

2.4 Before considering new interventions, policymakers should also consider whether the problem could be resolved by making changes to practices within the existing legislative framework. Examples of this are:

- making use of existing regulation;
- simplifying or clarifying existing regulation;
- improving enforcement of existing regulation; or
- making legal remedies more accessible or cheaper.

2.5 Past NAO work found merit in more consideration of these options across government. In particular considering clarification and communication of existing regulations.⁵ Businesses, in particular small and medium-sized enterprises, often find it burdensome to find information about which regulations apply to their business.⁶ Alternatives to regulation can be equally, if not potentially, more difficult for businesses to understand. Policymakers can consider what action to take to make existing regulatory requirements for businesses clear and more effectively communicated. An example is the government's Focus on Enforcement review of Volunteer Events. This led to a government guide about how to organise voluntary or community events.⁷

Information and education

2.6 Information and education can be used to empower consumers to make their own decisions, improving choice. Examples include independent recommendation schemes, rating systems and labelling. An example of this is the Food Standards Agency 'Food Hygiene Rating Scheme'. This scheme translates the results of food safety inspections into a food hygiene score that establishments can display.

⁵ National Audit Office, *Option Appraisal: Making informed decisions in Government*, May 2011.

⁶ National Audit Office, *Business Perceptions Survey 2014*, May 2014.

⁷ Available at: <http://discuss.bis.gov.uk/focusonenforcement/review-findings/volunteer-events-summary/>

2.7 The advantage of this approach is that it offers relative freedom for the consumer and does not intervene with the decision-making process. Instead it provides them with the information to help make a more informed decision. The approach can be integrated with other regulations as part of a wider policy package and reduce the costs of collecting information by consumers and citizens. There can be additional costs associated with providing information, but it can increase the likelihood of achieving intended outcomes.

2.8 There are potential risks associated with this. Information and education can take time to make an impact, be disseminated and for people to use it to change their behaviour. Access to information and the ability to use it can vary within a community and so may not reach all equally. It may also not be straightforward to assess how people will react or change their behaviour in response to the information provided. Although costs may be directed away from consumers, it may increase costs for government and businesses that will be providing the information and education required.

2.9 The Department for Transport (DfT) points to a case where education has had a positive impact in the maritime industry (**Figure 3**). Better understanding of the decision-making of crew and officers has improved accident rates at sea. In this case, the public body involved the maritime industry in discussions from the outset. Working with the industry proved key to the successful development of this alternative approach.

Figure 3

Case study: Information and Education, Maritime and Coastguard Agency

Human element error reduction programme

The Maritime and Coastguard Agency has developed a range of non-regulatory interventions aimed at improving maritime safety through guidance and education. The main thrust of the strategy is to enhance understanding of normal human behaviour, and how this critically impacts on safety in the maritime context. The Maritime and Coastguard Agency worked with industry to produce a practical guide to human behaviour and error reduction in the shipping industry. This has encouraged the industry to look afresh at the way officers and crews learn, work and make decisions, and the way individuals and organisations view and manage risk. This enables more effective risk and error management, leading to a reduction in accidents at sea.

Recognising the safety and commercial value of effective human element competence, the concepts and lessons from the human element guide are being adopted by industry.

Example 1

A company introduced a specific human element training module for all its cadets who surpass the standards required by current international regulation and traditional training.

Example 2

A company has reviewed its whole approach to operational leadership and management and has created its own internal staff development programme throughout the company based around effective human element practices.

Source: Department for Transport and Maritime and Coastguard Agency

Incentive or market-based structures

2.10 The government can use economic instruments, such as taxes, subsidies, quotas and permits, vouchers, auctions and competition to encourage business and citizens to change behaviour. Often these sorts of systems need regulation to establish the framework. An example is feed-in-tariffs which incentivises households to install renewables. This helps households reduce their energy bills and make money from any surplus electricity they make.

2.11 If appropriate incentives are put in place compliance can be high and desired behaviours may help achieve policy objectives. This approach offers businesses and citizens flexibility. There is likely to be a strong incentive for businesses and citizens to find the lowest cost response to deliver the desired benefits. Incentive or market-based structures also avoid intervention and enforcement, which can be present in more rule-based styles of regulation.

2.12 The approach can have disadvantages. It may, for example, be difficult to determine the size of the incentive required to change the behaviour needed among businesses and citizens. Rules can be complicated (for example taxation rules or subsidy arrangements). Predicting the effects of incentives may be difficult and there is often uncertainty when the effects will occur. Although there is flexibility for the consumer, it may be difficult for the government to deliver change, particularly if the new incentive is less attractive to businesses or citizens.

Alternatives models of regulation

Self-regulation

2.13 An industry or a profession can self-regulate, for example through the use of codes of conduct, customer charters, standards or accreditation. In many cases rules and codes of conduct will be formulated by a trade association, or other industry representative under their own initiative. In other cases, an industry or profession self-regulate in response to delivering a stated government objective. In self-regulation, the industry is solely responsible for monitoring and enforcing members' compliance. This enforcement can be achieved either first hand or through other bodies set up by the industry.

2.14 An example of a self-regulatory system currently operating within industry is the Lion Quality Mark Egg Assurance scheme (**Figure 4** overleaf). This provides assurance to customers on the quality of their egg purchases. In this example, the outcome the government wishes to achieve (food safety) is in line with benefits for the industry (increased sales) and so there seems to be an industry incentive for self-regulation to work.

Figure 4

Case study: Voluntary Self-regulation, Department for Environment, Food & Rural Affairs

Lion Quality Mark Egg Assurance scheme

Since 2000, egg producers who are signed up to the British Egg Industry Council (BEIC) Code of Practice have used the 'Lion Quality' mark. This is a registered trademark stamped on egg shells and egg boxes. This code ensures eggs have been produced to high standards of food safety through vaccination and other measures. Certification bodies accredited by the UK Accreditation Service (UKAS) audit egg producers independently to ensure these standards are maintained.

The code has been successful, with about 85 per cent of UK eggs now being produced to 'Lion Quality' standards. A 2007 report published by the European Food Safety Authority confirmed that UK egg production is among the safest in the world. The report also showed that while several countries reported levels of salmonella of more than 50 per cent on their flock holdings, the UK figure was only 8 per cent. The 2009 figures have shown that salmonella of public health significance on laying flocks in the UK has since fallen to 0.35 per cent.

Source: Department for Environment, Food & Rural Affairs

2.15 The advantage of self-regulation is that it can engender a degree of ownership of regulation within the industry. As schemes are developed and often administered by business, it can lower both administration costs for government and compliance costs for businesses. Rule-making may be better informed and rules may be tailored to specific needs, meaning the regulation is better targeted.

2.16 There are however risks that regulations can become self-serving for the industry and sanctions for non-compliance are not as effective as they should be. As the regulatory approach is run within the industry, rule-making may become closed to the public or consumers. There can be risks that incumbents use these rules to exclude newcomers from the market and damage competition. Governance of such schemes could also be less transparent than government activity. These risks can be mitigated through effective design of self-regulation. This includes a transparent process, introducing independent and accessible conflict and dispute resolution mechanisms, and involving a broad range of stakeholders.

2.17 There are also potential risks from the way the government implements such schemes, for example confusion about the status and enforceability of such arrangements. Also if government creates the perception that if businesses don't join, regulation will be introduced, this could be seen as regulation through the back door.

Goal-based regulation

2.18 Goal-based regulation focuses on setting an objective rather than specifying rules. For example the objective could be that people should be safe when working at heights, rather than specifying when ladders should or should not be used.

2.19 Goal-based regulation is likely to be most effective when there is a clear outcome but regulators do not have full access to information about the industry processes, particularly if there is rapid technological change within the industry or the industry has complex and technical processes. Also goal-based regulation can be more responsive to changes in the market. It is much easier to make changes that depend on the behaviour of the regulator under goal-based regulation. Under rules-based regulation, any changes require the department to go back to the original legislation.

2.20 When using a rules-based approach a business could follow the regulation and feel as if it has discharged its legal responsibility. However, accidents or consumer detriment could still occur, and the objective of regulation would not be met. The incentive for the regulator, therefore, is to have very specific rules to try and prevent accidents or detriment occurring. The development of such rules may end up being slow moving. This also creates incentives for business to see the regulator as responsible for setting the right rules.

2.21 Rules-based regulations may also prevent new business models from entering a market, if they cannot comply with the rules set out in the regulation. However, these businesses may still be able to comply with the underlying objectives for the regulation.

2.22 A goal-based approach gives businesses additional flexibility about how they comply with regulation. It also gives regulators flexibility to adjust the regulation to market conditions. Government and regulators often provide guidance to support goal-based regulation to give advice about how businesses can comply with regulation. Depending on circumstance, this guidance will vary in its legal status and the degree of specificity. The implementation of a goal-based approach can change where this intervention sits on the spectrum (Figure 2). Implementation would most likely be between these two extremes:

- Market-based implementation: the government can set the objectives and allow industry and individual business to work out its own solution. The business can be flexible in the approach it takes to achieving the objective but it may be difficult for the business to demonstrate that they are compliant.
- Rules-based solution: the government can provide detailed guidance alongside the objective. This would make compliance easier and help smaller businesses entering a market. This guidance could be used to judge if businesses are compliant (used in courts to show liability). This means the guidance has the same impact on the businesses as the rules-based approach. Although without guidance it can be very difficult for businesses, especially small ones, to understand whether they will achieve the objective.

Co-regulation

2.23 Co-regulation (also known as enforced self-regulation) is an intermediate step between state-imposed and self-regulation. It involves some degree of explicit government involvement, beyond a stated government objective. For example, an industry may work with government to develop a code of practice. Enforcement would be by the industry or a professional organisation and accredited by government. Examples of such regulation are recognised codes, approved codes and standards and accreditation where government has been actively involved in the process. The advantages and disadvantages are similar to those of self-regulatory approaches.

2.24 Figure 5 sets out an example of where government and industry have worked together to deliver a regulatory approach in the farming industry. The example shows how both parties are benefiting from this alternative model of delivering regulation.

Figure 5

Case study: Co-regulation, Environment Agency

Pig and Poultry Assurance Scheme

The Environment Agency (EA) introduced an earned recognition scheme for pig and poultry farms in 2011, developed with the National Farmers' Union. Instead of the EA visiting farms at least once a year, high performing farms can be invited to join the Pig and Poultry Assurance Scheme and be visited by third party Certification Bodies instead. The EA will then visit once every three years. Farmers save £880 on their annual subsistence fee through this scheme. If the farm is also a member of Red Tractor Farm Assurance (a separate voluntary code of practice) visits can take place at the same time as the third party Certification Bodies' visit. This further decreases farm visits and saves the farmer time. The EA also benefit as their inspectors are freed up to focus on inspecting higher risk sites or those with a poor history of compliance.

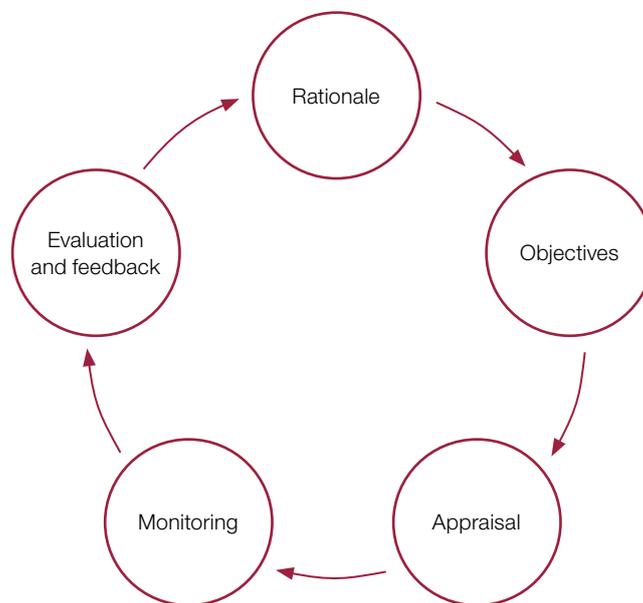
Source: Department for Environment, Food & Rural Affairs

Part Three

Consideration of alternatives in the policy development process

3.1 This part sets out the processes policymakers go through when identifying a problem, and how they consider the approaches they could take to achieve their policy objectives. **Figure 6** sets out the policymaking cycle. The policymaking process requires policymakers to outline the policy options considered and, when regulation is proposed, to show the outcome cannot be achieved by a non-regulatory approach. The extent to which policy officials can achieve this often depends on the driver behind the regulation.

Figure 6
Policymaking process



Source: HM Treasury, *The Green Book*, July 2011

3.2 The Regulatory Policy Committee (RPC) recommends that departments do not 'presume regulation is the answer' and so encourages departments to consider non-regulatory alternatives.⁸

Involving stakeholders

3.3 All key stakeholders should be involved at the early stages of policymaking. If a number of stakeholders are involved at this stage, a wider range of regulatory and non-regulatory options should be identified. Internal stakeholders include: policymakers; better regulation teams; behavioural economists; economists; lawyers; and social researchers. External stakeholders include: industry groups; businesses; third sector organisations; and citizens.

3.4 Involvement of analytical staff early in the policymaking process can be valuable, as can involving experts in the use and design of regulation who are typically found in the Better Regulation team. For example, in the Department for Environment, Food & Rural Affairs (DEFRA), the Better Regulation team is increasingly involved early in the policy cycle. Although the ministers make the overall decision on policy, the team tries to ensure that there is more than one option presented for consideration.

3.5 As the key decision-maker, ministerial backing of stakeholder involvement and consideration of alternatives is essential. DEFRA established the Farming Regulation Taskforce in 2010, by the Minister of State for Agriculture and Food. Its remit was to advise government on new approaches to regulation in England through the eyes of a farmer or food producer. The taskforce consisted of a range of stakeholders, including farmers, a solicitor, the former director general of the National Farmers' Union and a supermarket director. They reported directly to the minister in 2011 and recommended that DEFRA must involve industry in the development of non-regulatory and regulatory solutions.

3.6 Many of the examples of alternative approaches currently in operation provided to us by departments point to the need for early engagement with business and industry. This should be done with a wide range of stakeholders, early on and in an ongoing way to review the success of an intervention. External stakeholders can provide additional expertise about how the market functions and likely responses of key actors. This information is important for designing effective alternatives.

3.7 **Figure 7** sets out an example of the ideal policymaking process when intervention in the public, private or third sector is being considered. The problem or issue should be thoroughly analysed and a number of options to address it explored. If policymakers determine a regulation is required; they must put together an impact assessment to consider the costs and benefits. The evidence and analysis presented in the impact assessment is ideally collected throughout the policymaking process.

⁸ Regulatory Policy Committee, *Improving the evidence base for regulation: Regulatory Policy Committee scrutiny in 2013*, March 2014.

Figure 7
Policymaking process and engagement

Policymaking process	Stakeholder involvement	Discussions
Issue/problem	Minister Key stakeholder groups Analytical staff	Early engagement can help clarify the nature and extent of the problem and resolve if government intervention is needed. Early consultation can help resolve if government intervention is needed.
Analysis of issue/problem		
Presentation of issues with options	Minister Key stakeholder groups Analytical staff	Ensure presentation is clear to the decision-maker Consultation tests the feasibility of options presented
Explore options further	Minister Key stakeholder groups Analytical staff	Are the options addressing the initial problem?
Analyse options further	Analytical staff Lawyers	Use a wide range of skills to investigate the consequences of the options.
Detailed options		
Develop impact assessment/ business case		

Note

- 1 Each policymaking process will involve other key stakeholders depending on each individual case. This example is derived from one of our case studies.

Source: National Audit Office interviews with departmental staff

3.8 This can also be helped by a good quality consultation stage. Although this can be done outside of, or alongside, the formal consultation process. Departments should ensure that impact assessments properly assess the costs and benefits of a range of policy options when entering consultation. This gives stakeholders the chance to contribute to the design of the regulation in a more effective manner. Without this, consultees have no opportunity to comment on the costs and benefits of alternatives as compared with regulation. This is in line with Cabinet Office principles on consultation, specifically the principles of transparency.⁹

9 Cabinet Office, *Consultation principles: guidance*, November 2013.

Part Four

Where efforts might be focused to generate further alternatives

4.1 It is difficult to provide an accurate picture of the extent to which departments are using alternatives as there is no measure of their use. Therefore, this part examines where departments should focus their efforts on exploring where alternatives to regulation could be used.

4.2 The RPC found that ten proposals that reached final stage in 2013 contributed over three-quarters of the costs and three-fifths of the cost savings to business. These proposals covered a range of policy areas, from employment rights, to consumer protection and gambling stakes.¹⁰ There could be measures with a small estimated net cost or saving to business which will represent big increases in some costs offset by big savings in others, or a large indirect cost or benefit. Nevertheless, the broad picture suggests there is scope for focusing efforts on finding significant alternatives on a relatively small number of new regulations.

4.3 The government's objective is to reduce the cost to business of regulation and the value of the impact provides a useful indicator of where to focus efforts. Those regulations with large estimated costs provide opportunities to explore alternatives and see if the costs to business could be reduced. Alongside the value of the intervention there are other factors the policymakers could consider to help prioritise where to focus efforts on alternatives. These are:

The level of risk

- If this intervention is being proposed to address a serious concern it may not be as suitable for an alternative approach. This might be a significant environmental concern or emergency (e.g. BSE outbreak).

If a regulation builds on others

- If a regulation is adding new requirements to existing ones there may be scope to revisit whether a regulatory approach is still appropriate. If a department is adding new rules to keep up with a changing environment a goal-based approach might be more suitable.

¹⁰ Regulatory Policy Committee, *Improving the evidence base for regulation: Regulatory Policy Committee scrutiny in 2013*, March 2014.

- The number of bodies the government might need to interact with and the range of opinions they hold. A narrow range of interested stakeholders or closeness in stakeholder and government opinion could make it easier to reach a consensus. When dealing with a large number of separate entities or a broad spectrum of opinions more effort will be needed to consult and agree an approach.
- The strength of government's current relationship and contact with an industry. Or if industry already has in place its own communication approaches and methods for reaching consensus.

4.4 The effectiveness of alternatives depends on the behavioural response to the policy, so it can be helpful to pilot alternatives before they are fully introduced. Pilots are likely to be most feasible when there is limited pressure to respond to an issue. Therefore horizon scanning to identify future issues may identify policies where there is time and space to pilot alternatives.

Limitations of alternatives

4.5 While there are many examples where alternative approaches work and deliver the intended outcomes, alternatives will not work in all circumstances. **Figure 8** is an example where the government has proposed a self-regulatory approach be replaced with a regulation. The government's consultation in 2013 recognised that while there had been progress with self-regulation, it had not been sufficient to increase transparency in the pub company/tied tenant relationship. The government's response to its consultation was published in June 2014 and outlines plans to proceed with a statutory code and an independent adjudicator.¹¹

Figure 8

The British Beer and Pub Association

Case study: Self-regulation, Department for Business, Innovation & Skills

Organisations representing pub companies, brewers and tenants have developed a Framework Code of Practice which governs the business relationship between companies and publicans who operate tied public houses. A tied tenant is one that is required to buy at least some of its beer from a particular brewery. The Framework is the industry template for individual pub companies' own codes of practice. Individual company codes are accredited by the British Institute of Innkeeping. In addition, the industry has established a dispute resolution service to resolve rent disputes between pub companies and their tenants, and one to arbitrate where a tenant believes the pub company has breached either the industry or company code.

A number of parliamentary reports have outlined the problems within the pub industry and in particular, the relationship between pub companies and their lessees. Because of these reports, it was recommended that statutory intervention be used.

Source: Department for Business, Innovation & Skills, *Business, Innovation and Skills Committee*: 10th report, 20 September 2011

¹¹ Available at: www.gov.uk/government/consultations/pub-companies-and-tenants-consultation

4.6 It is vital, therefore, that policymakers consider the risks and advantages of each approach and consider each case individually. They should ensure they maintain oversight on the consequences of the approach that has been adopted.

Perceived barriers and possible solutions

4.7 **Figure 9** sets out some of the perceived barriers raised by policy officials and Better Regulation Unit staff. Against these perceptions we have set out some of the possible solutions arising from this work.

Risk created by limited appraisal of alternatives

4.8 The light touch approach to appraising alternatives is designed to give departments incentive to consider this type of approach. These lower requirements for appraisal could create risks for the alternatives being designed. This leads to risks, such as:

- missing possible impacts on competition;
- creating more burden than the rule-based approach to regulation; and
- not maximising benefits over costs.

4.9 The lack of formal appraisal also reduces the amount of information on alternatives for departments to learn from. One of the key issues explored in this report is the low evidence base for alternatives. A lack of appraisal evidence available will make it harder for lessons to be learned and shared between departments.

Figure 9

Perceived barriers and possible solutions to using alternatives

Perceived barrier**The cultural and political dimension**

Policymakers may lean instinctively towards rule-based regulation due the perception that:

- there is a 'regulate-first' culture among some ministers which limits consideration of alternatives
- regulation indicates that the government is acting decisively on an important issue

Risk

There are risks with alternatives which can act as barriers, such as uncertainty about whether alternatives will work and produce the desired outcome.

Regulation is seen as a lower risk response when:

- it is perceived to provide certainty, through concrete legislation leading to the achievement of the desired outcome
- policymakers are more familiar with regulation
- enforcement levers can increase compliance with regulation

Knowledge

There is a lack of knowledge of what alternatives are:

- policy staff do not feel they have the time or resources to improve their understanding of alternatives
- they lack expertise in providing the costs and benefits of alternatives
- there is a lack of evidence of successful alternatives

Resources

The lack of resources in funding and time can act as a barrier to using alternatives. In particular:

- to achieve the desired outcome through alternatives, funds are required for communication, which budget cuts have made difficult
- there is a sense that it is quicker to legislate as alternatives can take longer to develop, design and implement
- alternative approaches often rely on working well with industry and there is a sense that industry-led and behavioural approaches take time

Notes

- 1 These perceptions are taken from our workshops and interviews with policymakers, Better Regulation Unit staff and economists.
- 2 The possible solutions are our suggestions driven by the findings in this report.

Source: Interviews with departmental policy and Better Regulation Unit staff

Possible solution

Early involvement of different analytical disciplines to assess the need for government intervention

Stakeholders in the industry should be consulted early on to discuss if government intervention is necessary or feasible

Trialling policy responses before a problem becomes acute so there is less pressure for government to be seen to be acting

(Part Three and Figure 7)

In our workshops and interviews departmental staff suggested that sharing examples might help. A better understanding of where alternatives have worked may help address some of the concerns and ensure the right approach, either regulatory or alternative, is selected by policymakers

In Part Three we found that those with expertise in developing alternatives should be brought in at the earliest stage of policy development

A NAO seminar with Better Regulation Units found that evidence for alternatives could be drawn from a wide source of government interventions which are not labelled as alternatives

In our workshops and interviews departmental staff suggested they would have more confidence if there were more examples of:

- the cost of developing alternatives
- how alternatives can be cheaper as there can be less enforcement costs
- how consideration of alternatives as early as possible provides the time needed for development

Methodology

This paper was based on:

1 Desk research

- Review of NAO's past work
- Impact assessments
- Literature Review

2 Meetings with key stakeholders carried out between March and December 2013, including:

- Better Regulation Executive (BRE)
 - The Better Regulation Unit and policymakers from:
 - Department for Transport
 - Department for Business, Innovation & Skills
 - Department for Environment, Food & Rural Affairs
 - British Chambers of Commerce
 - Confederation of British Industry (CBI)
 - Federation of Small Businesses
- 3** A workshop of better regulation staff was run with around 20 participants to discuss their experiences of alternatives. This was run with Better Regulation Unit and policymaking staff in June 2013.
- 4** Seminar with Better Regulation Units in November 2013.

© National Audit Office 2014

The material featured in this document is subject to National Audit Office (NAO) copyright. The material may be copied or reproduced for non-commercial purposes only, namely reproduction for research, private study or for limited internal circulation within an organisation for the purpose of review.

Copying for non-commercial purposes is subject to the material being accompanied by a sufficient acknowledgement, reproduced accurately, and not being used in a misleading context. To reproduce NAO copyright material for any other use, you must contact copyright@nao.gsi.gov.uk. Please tell us who you are, the organisation you represent (if any) and how and why you wish to use our material. Please include your full contact details: name, address, telephone number and email.

Please note that the material featured in this document may not be reproduced for commercial gain without the NAO's express and direct permission and that the NAO reserves its right to pursue copyright infringement proceedings against individuals or companies who reproduce material for commercial gain without our permission.



National Audit Office