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**ASSESSING THE IMPACTS OF PROPOSED LAWS AND REGULATIONS**

**SIGMA PAPER No. 13**

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT**

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## THE SIGMA PROGRAMME

SIGMA -- Support for Improvement in Governance and Management in Central and Eastern European Countries -- is a joint initiative of the OECD Centre for Co-operation with the Economies in Transition and the European Union's Phare Programme. The initiative supports public administration reform efforts in thirteen countries in transition, and is financed mostly by Phare.

The Organisation for Economic Co-operation and Development is an intergovernmental organisation of 29 democracies with advanced market economies. The Centre channels the Organisation's advice and assistance over a wide range of economic issues to reforming countries in Central and Eastern Europe and the former Soviet Union. Phare provides grant financing to support its partner countries in Central and Eastern Europe to the stage where they are ready to assume the obligations of membership of the European Union.

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

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

SIGMA aims to:

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

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

SIGMA works in five technical areas: Administrative Reform and National Strategies, Management of Policy-making, Expenditure Management, Management of the Public Service, and Administrative Oversight. In addition, an Information Services Unit disseminates published and on-line materials on public management topics.

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## FOREWORD

This publication deals with policy assessment and Regulatory Impact Analysis (RIA), or the *ex ante* assessment of how proposed legislation and regulations will affect a country's economy, budget and existing laws. Most of the papers focus on the expected economic impacts.

The compilation is a follow-up to the seminar that was held in Riga on 2 and 3 October 1996 for public officials of the Baltic countries (Estonia, Latvia and Lithuania). It comprises the papers that were prepared for the seminar by experts, along with a brief summary of discussions which took place over the course of the two days.

Like *ex post facto* policy evaluation, from which it borrows its main approaches, the purpose of RIA is to improve the quality of government interventions. It operates on familiar principles and seeks first to ensure that the impacts both intended and unintended of proposed legislation and regulations are assessed in advance, and form an input into decision-making. In other words, RIA begins by answering the questions: "Will the proposed intervention actually cause welfare to increase? What are its economic effects, i.e. how do the benefits stack up against the costs?"

Next, RIA highlights the strictly redistributive impact of proposed government intervention and establishes precisely who wins, who pays and how much. In this, RIA transposes the traditional perspective of fiscal and budget policies into the realm of laws and regulations. Lastly, the desired improvement to those laws and regulations stems also from the fact that RIA looks at risk factors and feasibility of implementation.

The aims of RIA are clearly broader than economic efficiency alone, even if, historically, most of its methods have been derived from economics. Because it factors in possible redistributive effects, risks and administrative feasibility, this instrument of analysis is a tool that can help improve policy-making in the broadest sense of the word. It can also enhance democracy by fostering maximum transparency in legislative and regulatory decisions.

Through the seminar, participants were able to examine the challenge of undertaking RIA in Estonia, Latvia and Lithuania, in light of RIA practices and methods in a number of OECD countries. The most pressing problems in this area stem from a legislative and regulatory overload as the Baltic countries seek simultaneously to complete the transformation of their systems of government and prepare for membership in the European Union (EU). This means that a large number of laws and regulations have to be drafted by governments and passed by Parliaments in a short time. Taken together, these laws can be expected to have a substantial impact on budgets, economies and the social fabric. Yet officials often feel that they are not allowed time to assess the consequences in an attempt to minimise the negative ones.

Moreover, Baltic officials have little experience with RIA techniques of analysis. For this reason, a large part of the dialogue during the seminar dealt with how to decide which of the myriad initiatives should be subject to RIA; to economise on analytical and co-ordination resources; how to collect information; and how to meet training needs in this area.

The papers by John Morrall, François Stasse and François Lacasse, as well as remarks by Scott Jacobs and Juhani Korhonen, stressed the historical development of RIA in various OECD countries in order to highlight the lessons to be learned by the Baltic countries. It is therefore appropriate that the experts' presentations and interventions paid as much attention to how RIA could be initiated, administered, and improved as to the methods of analysis themselves.

In any event, it emerges clearly that, in this area, analytical methods that are standardised, universally acknowledged and accepted must co-exist with strategies and systems for instituting and utilising RIA that are shaped largely by national preferences and traditions.

SIGMA wishes to thank the authors of the papers reproduced herein, the other experts who took part in the seminar and, especially, the hosts and initiators of the gathering—the Latvian Government, and particularly Mr. Zorzs Tikmers, Director of the Chancellery.

Begun at SIGMA under the responsibility of Jean-Pierre Rostaing, the project was continued by Anke Freibert and Michal Ben-Gera. François Lacasse, professor at the Université du Québec in Hull, Quebec, Canada, compiled this publication. At SIGMA, the project proceeded smoothly thanks to Linda Duboscq, Joanne Stoddart and Winnie Marshall.

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Other SIGMA publications related to reforming the regulatory process in central and eastern European countries include *Improving the Quality of Laws and Regulations: Economic, Legal and Managerial Techniques* (1994); SIGMA Paper No. 14 *Civil Service Legislation: Checklist on Secondary Legislation (and Other Regulatory Instruments)*; SIGMA Paper No. 15 *Checklist on Law Drafting and Regulatory Management in Central and Eastern Europe*; and SIGMA Paper No. 18 *Law Drafting and Regulatory Management in Central and Eastern Europe* (forthcoming October 1997).

A compilation of international RIA practices will appear in *Regulatory Impact Analysis: Best Practices in OECD Countries* (forthcoming autumn 1997), PUMA, OECD, Paris.

This present SIGMA publication is available in English and French on the SIGMA Web site at <http://www.oecd.org/puma/sigmaweb>.

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## EXECUTIVE SUMMARY

*Assessing the Impacts of Proposed Laws and Regulations* deals with policy assessment and Regulatory Impact Analysis (RIA), or the *ex ante* assessment of how proposed legislation and regulations will affect a country's economy, society, budget and existing laws, international agreements, etc. Through RIA governments can improve the quality of their interventions by ensuring that the impacts, both intended and unintended, of proposed legislation and regulations are assessed in advance, and form an input into decision-making. This is especially relevant for countries of Central and Eastern Europe in light of European Integration and the need for economic management.

This publication is a follow-up to a seminar that was held in Riga on 2 and 3 October 1996 for public officials of Estonia, Latvia and Lithuania. It comprises a brief description of the highlights of the seminar discussions and the three papers that were prepared for the seminar by experts from Canada, France and the United States. Canada and the United States are leaders in RIA technology, and France is adopting new methodologies.

The main messages of the seminar and this publication are that:

- It is incumbent on governments to attempt to determine, in advance, the potential impacts of the actions they plan to take. It is often known what the immediate budget impacts would be, but government actions may generate costs to industry, raise prices of consumer goods, affect safety on the roads or reduce the supply of teachers. Many such impacts cannot be known without careful analysis.
- The main purpose of advance assessment is to help choose among alternative approaches for meeting policy objectives. The purpose is to minimise budgetary, economic and social costs, while still meeting the policy goals.
- There are now well-developed methodologies and expertise that can be borrowed and adapted by any government wishing to conduct RIA.
- RIA need not be expensive. If resources are limited, it is possible to plan modest assessments that would nevertheless yield useful, cost-efficient results.
- To be useful, RIA should be institutionally linked to decision-making and law-drafting.
- RIA is only useful if there is both a political and an administrative commitment to take the results of RIA into account in the decision-making process.
- RIA provides factual information on the expected outcomes of decisions. Decision-makers should take this information into account in addition to other considerations which affect government decision-making, such as constitutional requirements, political commitments, ideology or international agreements.

Through the seminar, participants were able to examine the challenge of undertaking RIA in Estonia, Latvia and Lithuania, in the light of RIA practices and methods in a number of OECD countries. They noted that the most pressing problems in this area stem from a legislative and regulatory overload as Estonia, Latvia and Lithuania seek simultaneously to complete the transformation of their systems of government and prepare for membership in the European Union. Moreover, officials in Estonia, Latvia and Lithuania have little experience with RIA techniques of analysis. A summary of the exchanges between Baltic participants and foreign experts are included in this publication in a chapter entitled “Challenges, OECD Experience and Baltic Particularities: Highlights of the Riga Seminar”.

The volume also includes the full texts of the papers presented at the seminar by John Morrall (USA), “Using RIA to Improve Legislation and Regulation: The American Experience and Its Relevance for Central and Eastern European Countries”; François Stasse (France), “Public Policy Assessment in France”; and François Lacasse (Canada), “Issues in the Central Assessment and Evaluation of Policy Initiatives and Instruments Choice”.

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## OPENING STATEMENT

*Madame Chairman*  
*Excellencies*  
*Ladies and Gentlemen!*

I have particular pleasure to welcome you today in Riga, at the workshop of three Baltic states on “Evaluation of the Impacts of Legislation”<sup>1</sup>.

Permit me to extend my sincere gratitude to the SIGMA Programme, joint initiative of the European Union and the OECD, for accepting the initiative of the State Chancellery of the Republic of Latvia and for granting Latvia the privilege to be the host country.

As you all know this workshop is the first of its kind ever held in Central and Eastern Europe and, therefore, we are very honoured to be the pioneers in this field among the European post-communist countries. I would like to express a belief that our first workshop on this theme will be a success and that our three countries will gain a new impetus for improvement of legislative acts.

*Ladies and Gentlemen!*

During the last six, seven years the Baltic states have witnessed a real boost of legislative activity. The legislature and the legal experts face the problem of quality of legislative acts on an everyday basis, but today they do not have to face the problem in optimistic loneliness. We have made another small, but important, step towards the usage of knowledge presented by European and American experts in the field.

Let me quote you an excerpt from the Declaration of Cabinet of Minister’s work of the Republic of Latvia, in order to show the significance of this particular workshop for Latvia: “the government undertakes to realise the following tasks regarding the legal system regulation: Improvement of law drafting, perfecting the legal expertise of drafts and co-ordinating them with the valid laws within the limits of legal system...”.

*Dear Experts!*

Representative of three Baltic states have gathered in this conference hall to get acquainted with the methodology of evaluation of the draft legislative acts. After the workshop they will disseminate the knowledge acquired during the two days to their colleagues. Therefore, the audience today, in fact, is much wider.

This workshop manifests our common interest in getting legislation of the Baltic states to a new level of perfection. I certainly believe that our concerted efforts in this field will continue.

*Madame Chairman!*

The co-operation between Latvia and SIGMA has been very successful and taking advantage of this, I would like to assure the foreign experts and SIGMA that the input of knowledge and experience you have contributed earlier has been used appropriately and rationally.

On behalf of the State Chancellery of the Republic of Latvia I would like to express appreciation and gratitude to the SIGMA Programme for dedicated work.

Thank you very much for your attention and I wish the participants good luck in exploring the impacts of legislation.

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1. Opening Statement given by Mr. Zorzs Tikmers, Director of the State Chancellery of the Republic of Latvia.

## **CHALLENGES, OECD EXPERIENCES AND BALTIC PARTICULARITIES: HIGHLIGHTS OF THE RIGA SEMINAR**

At the outset, the seminar's host (Mr. Zorzs Tikmers) and its co-chair (Ms. Michal Ben-Gera) stated the issues and outlined what was expected. The Baltic countries were undergoing an unprecedented rush of legislative and regulatory activity which was straining the analytical capacities of the systems and personnel in place. This was prompting concerns over the quality of proposed action and was making it necessary to improve procedures and methods prior to the enactment stage.

In recent decades, a number of OECD countries had set up systems that were helping them to cope with similar problems. Those systems would be especially helpful to the Baltic countries in that they had been introduced over a number of years, had known both successes and failures and had triggered remedial action that had not always been foreseen. Lessons from the West's experience emerged all the more concretely because progress had taken considerable effort, although lessons were incomplete and were still being explored and updated.

The first presentation, by Mr. John F. Morrall III, looked at the US experience with RIA. It emphasised the following points:

- The system had taken twenty years to reach its current state of development, having originated in a period of stagflation when it became clear that the government's microeconomic interventions needed better controls and, in particular, that regulations that would affect market mechanisms should not be enacted without a full understanding of their impact.
- RIA is a long and costly process; only the most substantial regulations (US\$100 million and up) were submitted to such scrutiny. An elaborate selection system — based on potential economic effects — had been set up gradually and was now performing satisfactorily. Even so, in view of the latest estimates that the cost of regulation in the United States had reached 10 per cent of GDP, a great deal could be gained by improving the quality of laws and regulations.
- All of the opinions, research, discussions with pressure groups and conclusions of the entity responsible for RIA—which is part of the Office of Management and Budget (OMB) — are made public. This had not been the case initially, but such transparency proved necessary for the system's technical integrity as well as its political acceptability.

With regard to the need for this type of analysis in the Baltic countries, Latvian participants pointed out *inter alia* that a system recently instituted (in June 1996) made it standard practice for the Chancellery to compile the opinions of relevant senior Government officials in respect of four aspects: the consistency of proposed legislation with existing laws; its budgetary and economic consequences; funding; and the impact on international agreements in force or under discussion. On this last point, the need for prior scrutiny and extensive consultation stemmed from the fact that the country was not yet in a position to enter into all of the multilateral agreements it would like to, because a large number of fundamental laws

still needed to be overhauled. Speakers stressed that the system did not work very well yet and that, in particular, reviews of economic and budgetary repercussions were rarely carried out satisfactorily.

The Lithuanian Delegation stressed the enormity of the legislative task it was facing: over 1 500 laws had to be changed extensively in a system in which amending the Constitution was also a major and high priority undertaking — a system that, moreover, was accustomed to neither endeavours such as RIA nor such a heavy workload. After an allusion to the cumbersome procedures that had been inherited from the previous regime, it was established that the most pressing RIA problem was how to select the bills to which scarce resources of time and analytical capacity would be devoted. In this regard, the situation seemed very similar to the one that had been described in Latvia.

In Estonia, in the context of successful macroeconomic policies and social problems common to transitional economies, certain difficulties had been encountered in the formulation of laws. Despite a formal requirement that each bill be accompanied by an analysis of its economic and social impact, in practice compliance with this was rare. The reasons were the cost involved, a scarcity of qualified personnel, the intensity of political pressures, the changing nature of the Government's commitment in this area, and the fact that the body responsible (the Chancellery) lacked the power to block a proposal that failed to meet the requirements for analysis. Moreover, as in OECD countries, Estonia was having to juggle difficult questions of equity — which are less readily dealt with by conventional impact analysis — with the manoeuvring of pressure groups, and with the time needed to establish the legitimacy and authority of RIA and the institutions producing it. Lastly, as in the other Baltic countries, the magnitude and the urgency of the legislative agenda of transition were substantial. Significantly, the Estonian Government was about to set up a special unit to analyse the impact of proposed legislation.

It was pointed out, particularly in response to remarks by Latvian and Lithuanian speakers, who emphasised budget-related RIA, that practitioners in the OECD countries deemed it essential for the analysis to distinguish between budgetary impact and economic impact. For example, a regulation mandating that only non-flammable materials be used in residential construction would clearly have a positive budget impact (by reducing fire-fighting expenditure), but it would just as clearly have a negative economic impact (a rise in the price of new dwellings such that housing conditions would deteriorate). Likewise, imposing pension schemes on employers might take some pressure off the budget, but it would also damage the economy.

This distinction had been deemed absolutely essential in the OECD countries to counter the virtually universal tendency of budget authorities to try to shift the costs of government intervention to the private sector, even if it meant major distortions in the market and a lack of transparency in public policy-making because it is difficult for voters to know the relevant costs and benefits (or the distribution thereof). In a number of countries, RIA had in fact been instituted to ensure that the costs and benefits of government regulation and legislation would be scrutinised as closely as those of budgetary provisions, even — and especially — if their direct impact on the budget were either slight or non-existent.

The second half of Mr. Morrall's presentation illustrated how the US system tried to address a number of problems similar to the ones cited by the Baltic participants. He noted the following:

- With regard to resources, outside consultants were used extensively. In addition, the mere fact that the originators of a bill were required, prior to any actual analysis, to state the needs which their proposal was intended to address and to identify the winners and the losers was often sufficient to cause an untimely initiative to be amended or rejected, thus avoiding costly further analysis. Lastly, it was often the case that the required research had already been done, either domestically or abroad, and could thus be “borrowed” by others at little cost. In particular, this is

true for most investment projects, for which methods had generally been amply tried out in other contexts, e.g. by the World Bank.

- Very strict rules for RIA deadlines could satisfy political pressure with respect to timetables for the legislative agenda.
- The analysis clearly listed the distributive impact of initiatives, but naturally it did not comment on the appropriateness of any given distribution of income or wealth, which is a political issue.
- Analytical methods were highly standardised and to some extent all derived from cost-benefit analysis. There was a large assortment of reference works that described these techniques at all levels of sophistication. The OECD's published checklist of relevant elements constituted a simple introductory guide in this domain.

Mr. Juhani Korhonen pointed out that the Finnish experience also reflected some of the Baltic concerns. For example, the pressure generated by the number and scope of legislative changes required by Finland's recent entry into the EU had created a comparable workload. A strict selection process was therefore essential to choose which analysis should be carried out. In Finland, a partial solution had been to call upon advisory units specialised in a variety of fields. As for the impatience of those who advocated particular legislative or regulatory changes, it seemed that this was a universal phenomenon. A partial remedy had been to require such people to address the risks involved in bypassing RIA, since hastily thrown together legislation that had to be done over again six months later entailed substantial political and economic costs.

One of the Lithuanian concerns was that RIA was too exclusively a matter for the executive branch of government and that the elected representatives who ultimately adopted the legislation ought to have access also to objective information as to its impact. In this respect the investigative bodies of the US Congress — which were independent of the executive branch — were a model, but they had no equivalents in Lithuania.

In Latvia, it was pointed out, the Parliament had made the mistake of passing "spontaneous" legislation which turned out to be either costly or unenforceable. Thought was now being given to how action in this area could be circumscribed. Clearly, as in the United States, a shift of this nature would take time; it was uncertain whether it was possible at this time to create effective RIA entities that could serve both the executive branch and Parliament at the same time.

It was pointed out that laws that, in France, were amended by Members of Parliament, were in fact generally better than those that emanated from executive branch experts alone. This fact was a useful reminder that the quality of laws was controlled not only by painstaking calculations but also by a sense of proportion and balance which was born of democratic control and transparent processes. It was from this standpoint that experts who worked directly for Parliament could prove valuable.

Mr. François Stasse's presentation focused on France's experience with the evaluation of policies and convergent systems (budgetary, political, legislative and judicial) for controlling legislative and regulatory activity. A RIA system had in fact just been instituted in France, and its results were not yet known. Mr. Stasse highlighted:

- The difficulties historically encountered in using methods of *ex post facto* multi-criteria and cost-benefit analysis, even though those methods were very well understood. The problems could be explained by specifically French traditions involving the low legitimacy of questioning

the State's actions, as well as by a number of dubious choices, such as the overly ambitious goals of *Rationalisation des choix budgétaires* (RCB) or, more recently, the institutional structure into which the born-again evaluation system had been incorporated and the excessively technical nature of reports it generated.

- The use of sectoral models facilitate *de facto* RIA in constantly changing and complex areas such as the Common Agricultural Policy and European assistance mechanisms.
- The inverse relationship between the complexity of models and the extent to which those models were actually used. Analysis also, and above all, needed to explain the reasons for government action to the nation; it therefore had to be widely understood.

Participants from Lithuania explained that the law-making procedure was already extremely cumbersome, involving a huge number of people and institutions. Given the volume and urgency of the necessary changes, certain issues were particularly important, such as the relevant practices and requirements of the EU and, within the Member States, the hierarchical and organisational structures that enhanced the quality of law-making.

Mr. Stasse stressed that EU bodies do not have any competence of their own to analyse regulatory or legislative impact, except, obviously, for cases in which an initiative impinges on the treaty. RIA is carried out by the Member States, as has been the case with regard to catalytic converters.

As for structural aspects of assessments, in France the promoting ministry first submits its proposal to the Ministry of Finance, and then to the General Secretariat of the Government, with major undertakings being submitted to the Council of State. In Parliament, specialised committees review each draft before it is adopted. The Council of State is composed of jurists who, depending on the matters involved, call upon experts in the relevant fields.

In Finland, beginning in the 1970s, strict instructions had been given to ensure that the quality of proposed legislation was improved. In particular, it was sought to make ministers accountable for the drafting of laws and to make certain that impact studies were carried out and discussed in public. There were a great many subsequent amendments to these directives, and to the system in general, essentially because results fell short of expectations. The drafting of legislation was of fairly mediocre quality, as was impact analysis — in the rare cases in which any analysis worthy of the name had actually been produced. Recently, to correct the situation, a joint effort had been initiated by the Ministry of Justice and the Ministry of Finance to bolster centralised control over the process while at the same time requiring ministries wishing to enact changes to carry out most of the necessary analysis.

Questions about the scope of such analysis, from Lithuanian participants in particular, brought similar responses concerning the United States, Canada and Finland: proper RIA touched upon economic, judicial, social, international and other aspects of the matter at hand. For this reason, it systematically required the services of a pool of broad and highly varied expertise which was generally well beyond the normal capabilities of a ministry. This was why it was so important to have criteria for selecting the legislative and regulatory proposals that would be subject to analysis. In France, for example, reform of the Criminal Code was a gigantic project which called upon a host of highly diverse experts; in contrast, changes in defence policy had been studied by a very small group, for obvious reasons. In general, the cost of conducting an assessment should be proportionate to the potential impact of the regulation.

With regard to the institutional arrangements for selection of targets for RIA, it was pointed out that a large number of variants were in existence in the OECD countries. For instance, the United Kingdom

required of ministries — long before Parliamentary debates and even before a proposal could be discussed by the Cabinet — that the proponents of any change examine the purported needs and alternative budgetary, regulatory and organisational solutions. In Sweden, the most important studies were conducted by a body with broad autonomy (ESO, or Policy Study Group), and its conclusions were often published even before line ministries began the actual process of drafting laws and regulations.

Timing constraints often limited the implementation and utilisation of RIA. How this constraint was handled varied from one country to another. In Finland, the Prime Minister's Office played a crucial role in this, frequently on the basis of a preliminary assessment of the identity of the groups affected by the intended action. In the United States, the inherent institutional slowness of the legislative process lessened the problem, as did the existence of competing research entities: those of Congress, those of the private sector and those connected with the political parties. The French experience had demonstrated abundantly that bills drafted hastily under "HIGH" priority were usually of low quality, and it was the responsibility of the central authorities to correct this sort of drift. Clearly, devotees of a particular "solution" — which frequently advanced the interests of a specific group — have often used urgency as a pretext for avoiding scrutiny of their demands.

Mr. François Lacasse's presentation dealt with the relationships between RIA and *ex post facto* evaluation; the organisational and institutional dimensions of these activities; and the priority areas in which it was virtually certain that RIA needed to be carried out. His most important points were as follows:

- In comparison with *ex post facto* evaluation, *ex ante* RIA was a recent phenomenon and not as widespread in the OECD area. Because the methods involved, and many of the institutional difficulties in using it, were basically the same in both cases, the lessons learned from the former could be applied to setting up systems for the *ex ante* assessment of laws and regulations.
- There is broad consensus that methods of analysis are solid and well honed, well formulated and readily accessible. Issues still under discussion included how to calculate risks arising from guarantees, proper risk-sharing methods, etc. These elements were clearly important but in most cases only secondary. This was not the case of distributive measures, however, for which two delicate problems persist: a) how to choose one measure from amongst a number of options, all of which were technically correct (e.g. should the redistributive impact of a new tax be gauged on the basis of household or individual incomes, current or lifetime income, etc.); b) how to communicate and interpret results. In the area of health care, for example, findings involving the cost of saving a life frequently clashed with a non-technical line of reasoning which rightly refused to put a price tag on human life.
- The institutional and organisational lessons to be learned from the OECD countries' experience were subtler and more complex. Despite their interdependence, the production of analysis needed to be distinguished from the organisational and institutional design for its use.
- On an organisational level, the pivotal issue was to ensure that the required research be in fact carried out using acceptable standards. Accumulated experience was sufficiently uniform to suggest that incentive systems played a crucial role, as did the stringency of controls over the quality and relevance of analysis. With regard to incentives, ministerial bodies needed to be actively involved, whereas control functions had to be centralised in order to work properly, essentially because of vulnerability to manipulations of methods of calculation. Everywhere, acquiring expertise had proved a far less extensive problem than had been feared at the outset.

This pleasant surprise reflected the fact that methods of analysis were standardised and had been stabilised.

- In contrast, the lessons to be learned from the way in which research was actually used were more fragile and, above all, less uniform from one country to another. Utilisation was the Achilles' heel of both *ex post facto* evaluations and RIAs — an area in which results should inspire humility in all of the OECD countries. It is a fact that studies could be churned out continuously and reflect high standards of quality without necessarily improving laws and regulations. In addition, the analysis needed to appear legitimate to policy-makers in order to be accepted by them and by lobbies, both public and private. In this regard, the most important factors are: a selection of studies capable of addressing the concerns of the Government and the electorate; a capacity to be readily circulated outside specialist circles; a jealously defended reputation for objectivity and scientific rigour; and acquisition and retention of institutional allies by those in charge of RIA. It would seem that the key success factors in these areas, from Finland to New Zealand, had been the transparency of the process for all relevant segments of society. Conversely, it seemed clear that all of the systems intended as essentially restricted to the public sector had failed.
- The areas which we now know required the most painstaking prior analysis are: the State's involvement in the realm of finance (banks and guarantees), its management of large public enterprises (monopolies as well as those in the competitive sector) and, lastly, unexpected expenditure drifts in redistributive policies involving entitlements.

The existence and accessibility of information in general, and of reliable data in particular, was an especially acute problem in the Baltic countries — and an issue that was raised by all of the Delegations.

Actual practice in the OECD countries could shed some initial perspective on the matter of what information was required to undertake RIA and evaluations.

For most RIA, the essential data had to be compiled during the course of the study; sometimes, for new and difficult subjects such as housing vouchers, it had been necessary to make use of highly expensive experimental techniques. More generally, the reliable data that were compiled routinely in the OECD countries were usually gathered for strictly administrative purposes having to do with the enforcement of existing laws. In most cases such data were of little use in meeting RIA requirements for proposed new initiatives. As a rule, the data available for *ex post facto* evaluation were more abundant and of a higher quality, generally because their collection had been required from the start, possibly as an element of programme administration and implementation. Also, the requirement of having to specify the information to be compiled in the administration of a new law can provide a useful basis for RIA, however rudimentary. In the end, however, despite their excellent and highly reputed statistical offices, the OECD countries that undertook RIA were very often obliged to specifically compile the data needed to do so.

As developed by Mr. Morrall and Mr. Scott Jacobs, the stringency of the analytical methods referred to in the seminar must not be confused with the normal need for law-makers to be properly informed. The urgency is often real, information is costly and time-consuming to compile. Such circumstances call for rapid techniques such as limited business surveys, consultations with small cores of experts, and the formation of small industrial review groups. These procedures do not replace formal analysis, but they do provide interesting signals and may prove useful in selecting which cases would require further study. In short, there is an entire range of techniques to compensate in part for information constraints and the resultant costs.

In Estonia, the present overhaul of the process of preparing laws and regulations is obviously intended to enhance the quality of legislation, and, to that end, it stipulates a uniform procedure, plans the order in which proposals should be presented, and is very precise in defining ministers' responsibilities, the steps to be taken and the consultations to be carried out. It is in this framework that RIA initiatives would be launched to determine environmental, economic, budgetary and international consequences and, in particular, considerations related to the European Union.

This is the case for bills put forward by the Government, but is far more difficult to implement for those originating in Parliament itself. In this latter instance, lobbies are an important issue, as is the overhaul planned to encourage, and at the same time control, the representation of pressure groups in the legislative process.

In Lithuania as well, changes of this sort are underway. For the moment, the priority is to put strict controls on the presentation of proposals: mandatory explanations of ends and means, mechanisms for internal and external consultations, strict delineation of the respective powers of Parliament and the Government, factoring in of the costs and capacities for implementation, etc. In view of the fact that in four years some 1 500 new laws had been adopted — in many cases opening up entirely new areas of legislation, such as property rights — it is hardly surprising that the reform is encountering difficulties and proceeding slowly.

In Latvia, the procedure currently in force makes it technically impossible to adopt a law without meeting requirements similar to the ones cited by the other Baltic countries. There, too, actual practice is lagging somewhat behind formal requirements.

It was commented that systems in the OECD countries had not been designed for extraordinary periods of legislative upheavals. More importantly, in systems as diverse as those of France and the United States, other bodies intervene in the legislative process either implicitly or explicitly, making it more likely that bills would be examined more attentively, and helping to keep Parliament and the Government from going too far astray. In particular, when strictly constitutional practices are well established, the legality of laws is checked by the courts or by bodies such as the French Council of State, not inside the government. This allows the government much more time to be devoted to questions of socio-economic impact and feasibility of implementation.

In addition, with regard to legislative planning, and particularly to reactions and adjustments to EU initiatives, the organisational model recently developed by the British seems especially appropriate for helping the Baltic countries to cope with their own special needs.

Mr. Jacobs' presentation focused on the principles of regulatory management accepted by the OECD and on how those principles could be implemented in the short term in situations such as those prevailing in the Baltic countries. The salient points were:

- It is now acknowledged that stringent regulatory management can be a significant factor in substantially boosting the economic growth rates and business development in countries. Achieving a high level of regulatory quality is important not only to a country's competitiveness, but also to the effectiveness of its legal structure and public sector. Five concrete steps in regulatory management reform were suggested by experience in OECD countries:
  1. First, an overall regulatory policy should be established by law or adopted at the highest levels of Government. The policy should establish the objectives of regulatory reform, and guidelines for the administration in how to exercise regulatory powers. The guidelines

could draw upon the Checklist for Regulatory Quality adopted by the Council of the OECD in March 1995. The policy would address the division of tasks between bodies such as ministries and centres of government; between laws and regulations; between the world of politics and that of public administration.

2. Second, it is necessary to develop managerial capacity at the centre of government so that an overall perspective could be expressed fully and counterbalance lobbies and the sectoral interests of ministries. This centre of regulatory control and initiative should be close to the budgetary and legislative processes alike.
3. Third, analytical capacity — both at the centre and in the ministries — should be developed gradually; initially, this would primarily involve the ability to gather the appropriate information on business impacts. Benefit-cost analysis, which can be difficult and costly, can come later; in the beginning, information on the feasibility of implementation and business impacts would have to take precedence. Training in analytical methods is readily accessible on the international scene, and it is possible to constitute small groups of experts who would support and train analytical capacities in regulatory bodies at the parliament.
4. Fourth, any system should incorporate a very large dose of consultations with those affected. Setting up appropriate systems is neither quick nor easy. It should begin with a mutual learning process with contacts from the private sector — a process that in many cases can be facilitated by the creation of advisory committees that meet regularly. Private-sector involvement could also help conserve resources in terms of research and expertise. However, the process also should be capable of ensuring that all relevant groups are heard and that it be transparent and public. Otherwise, it would become vulnerable to pressure groups and might lose credibility.
5. Fifth, any sound regulatory management requires a genuine system of communication, aimed at policy-makers as well as the various interest groups and electorates. The importance of high quality regulation and legislation should be stressed to offset pressures for poor regulation. This seemed to be a necessary condition for both the legitimacy of the system and its flexibility and ability to endure.

In Estonia, the scope of consultations now depends essentially on the minister involved and the Prime Minister. In respect of bills under preparation, the Government of Estonia is considering, along with systematic referral to a specialised institution, a requirement for extensive consultations very early in the process. It would ensure that these consultations take place in an effective manner, e.g. by requiring the minister to solicit the opinions of interested groups, then reply within a prescribed time limit, and publicly explain any agreement or disagreement with each of those opinions. In such a system, draft legislation and regulations would be made public long before they were submitted to Parliament.

In Lithuania, publication of legislative proposals generally takes place in the Ministry of Justice review. The perspective is predominantly judicial.

It was pointed out that, in most of the OECD countries, making proposed legislation public is now deemed a necessary but not a sufficient instrument of consultation and communication. In many cases it is considered that communication and consultation should be more clearly pro-active, and take place earlier.

**USING REGULATORY IMPACT ANALYSIS TO IMPROVE  
LEGISLATION AND REGULATION:  
THE AMERICAN EXPERIENCE AND ITS RELEVANCE FOR  
CENTRAL AND EASTERN EUROPEAN COUNTRIES  
BY JOHN F. MORRALL III<sup>2</sup>**

**1. Introduction**

Most of the member countries of the OECD use some system of regulatory impact analysis and review programme to improve the quality of their laws and regulations<sup>3</sup>. Partly in recognition of this fact, in 1995 the Council of the OECD adopted a recommendation that member countries of the OECD institute a check list of modern management techniques “to ensure the quality and transparency of government regulations”<sup>4</sup>. The wide spread use of regulatory impact analysis (RIA) systems is a relatively recent phenomenon. Twenty years ago only two countries—the United States and Canada—had even rudimentary systems. Why the growth and why the interest? The countries that have adopted these systems believe that a properly functioning RIA programme can increase per capita GDP and living standards and reduce inflation by opening up competition and improving the functioning of markets.

The evidence is all around us that the countries who embrace market economies and the democratic principles of governance are also the countries that have attained the highest standards of living. An objective of the RIA programmes as practiced by OECD countries is to use the market or market principles where appropriate to produce the benefits and protections that are the goals of government regulation in the most cost-effective and efficient manner. Governments use RIA programmes to achieve these goals by systematically analysing the expected effects of draft laws and regulations, and their feasible alternatives, on the social and economic welfare of their citizens. The resulting RIAs may then be used to make decisions based on this and other information. RIA programmes may be viewed as part of the world wide movement toward greater use of markets and market principles, which the economies in transition have embraced.

There are strong reasons to believe that less developed economies or economies in transition would also benefit from adopting modern public management techniques to control the costs to the public and the

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2. The author is an economist and branch chief at the US Office of Management and Budget who has been reviewing RIAs for over 20 years. He wrote this paper for SIGMA at the OECD while on leave from OMB. The views in this paper are his own and do not necessarily reflect the views of OMB, the US Government, SIGMA, or the OECD.
  3. The term “regulation” will generally be used in this paper broadly to refer to the full range of legal instruments by which governments impose obligations or constraints on private sector behavior. For a full definition see *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation* (Adopted on 9 March 1995), OECD, 1995.
  4. See *Recommendation of the Council of the OECD*, 1995.

drag on growth of poorly designed or excessive regulation. There is also reason to believe that countries with low per capita incomes have more to gain from efficient governmental policies than countries with high per capita incomes. Government waste is felt more by the citizens of low income countries who are closer to the subsistence level than by the citizens of high income countries. Since the per capita incomes of many of the central and eastern European countries (CEECs) is less than one tenth of the OECD countries' per capita income, the benefits in human terms of reducing any government inefficiencies and thereby increasing growth rates could be especially high.

A basic principle of economics is that every good outcome has an opportunity cost, i.e. the cost of the missed opportunity of not doing the next best thing. RIA programmes are no exception. They are not free and they are not easy to implement. But much can be learned from the failures and successes of other countries. It is possible to tailor a RIA programme to the needs and resources of specific countries. It makes little sense for a small low income country to require a comprehensive RIA programme. The United States does not require that a complete RIA be done for a regulation unless in general the regulation would have an annual impact on the US economy of US\$100 million or more, which scaled to the GDP of the Baltic countries amounts to approximately US\$100 000. That is partly because in the United States it may cost up to a million dollars to do certain high quality RIAs. But a RIA can also be simply a way to systematically think about a problem and organise the available data, if any, and information so as to facilitate rational decision-making. As such it need not be costly or time consuming. A key principle is that a RIA should not cost more than the potential improvement in the regulation that more rational decision-making is likely to bring about.

This paper is divided into ten parts. You are reading the first one. The second section answers the question: "What is the problem that RIAs are meant to solve?". The third discusses what a RIA is and how it can be helpful. Section four lists eight basic principles of good regulatory analysis that a prestigious group of economists has recently put forth. This discussion leads to section five, which explains how to do RIAs using the US RIA guidance document as the basis. The US RIA document is considered to be one of the most comprehensive in the OECD. The components of a high quality RIA in the United States include an analysis of the need for the proposed regulation, an examination of the alternative ways of accomplishing the objectives of the regulation, also known as cost-effectiveness analysis, and the benefit-cost analysis and discussion. Section 6 shows how the US programme uses RIAs to improve regulation. Sections 7 and 8 describe the other RIA programmes in the OECD countries and the programme, in the form of a checklist, that the OECD itself has formally endorsed. Section 9 attempts to provide a summary of the lessons learned and is designed to be helpful to the CEECs and the other countries in transition to market economies. Finally Section 10 ends with some thoughts about regulatory reform that may be important in the future to the CEECs.

## **2. What is the Problem that RIAs Are Meant to Solve?**

Poorly designed regulations can be costly to society and an impediment to the growth of an economy. The history of how the first RIA programme was set up illustrates this proposition. The United States was the first country to set up a programme to systematically review prospective regulations using economic analysis. In 1974 as a result of the oil price increases, the United States was faced with high unemployment and inflation, and low growth—a situation that gave rise to the term stagflation. Since the traditional macro economic tools of fiscal and monetary policy appeared to be ineffective when an economy faced simultaneously both high unemployment and inflation, President Ford convened an economic summit of the best economists in the United States. Out of the summit came the notion that government regulations and actions were often inflationary and harmful to job creation. The summit participants also proposed that a government agency at the centre of government (in the Executive Office

of the President) be created to monitor any inflationary regulations issued by the other ministries of the government (the departments and agencies). The agency created was called the Council on Wage and Price Stability (CWPS). The Office of Management and Budget (also part of the Executive Office of the President) issued a requirement that line ministries had to prepare inflation impact statements before they could issue new regulations. This inflation impact statements and monitoring programme evolved over the next twenty years into the current US centralised RIA programme as the next four US Presidents added to and improved the regulatory review programme

The adoption of regulatory reforms and RIA programmes during times of economic stress or hardship also occurred in other OECD countries. This phenomenon is no accident as these reforms can be a way to jump start an economy toward growth and stability.

According to one estimate for which the United States derived by adding up the cost findings of many separate studies of individual regulations, the aggregate cost to the private sector and lower levels of governments of complying with central government regulations in 1995 was US\$668 billion, or about 10 per cent of GDP<sup>5</sup>. Although these regulations obviously produce many societal benefits such as a cleaner environment or safer workplaces, there is clearly a large potential benefit to the welfare of citizens if regulations can be designed more cost effectively. This can be done either with lower costs for the same level of benefits or with greater benefits for the same level of costs. There have been many studies that found that certain types of regulations in particular produce no societal benefits, only costs<sup>6</sup>. In particular, regulations that restrict competition have been found to produce negative net benefits for society. Numerous other studies have found that regulations that do produce net benefits for society often could have done so at lower costs.

There have also been several large scale econometric studies that estimate that in addition to the costs of compliance certain regulations produce additional negative effects on productivity and innovation that may reduce the overall US growth rate in GDP by about 0.5 per cent per year<sup>7</sup>. Over a ten year period this effect would produce a relative decline in US living standards of over 5 per cent.

One difference in the problems facing most OECD countries and the CEECs involves the desire of those countries to quickly harmonise their laws and regulations with those of the EU in order to join the internal market. This factor introduces additional complications but ones which RIA programmes can be designed to solve. At least two complications are introduced: lack of time and lack of discretion. Fortunately the two problems tend to cancel. Having fewer alternatives to examine requires less time. RIAs are well suited to examining alternative ways of accomplishing a given objective. A major component of most countries' RIA guidance is the examination of the costs and benefits of alternatives. A difference that the CEECs face in many instances is that they do not have the alternative to do nothing, i.e. not regulate. However given the fact that a regulation must be issued, a particular part of a RIA, cost-effectiveness analysis, can be very useful in reducing regulatory inefficiency and enhancing economic growth.

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5. See Thomas D. Hopkins, "The Economic Cost of Regulation", *The Journal of Regulation and Social Costs*, Vol. 2, No. 1, March 1992.

6. For example see Robert Hahn and John Hird, "The Costs and Benefits of Regulation: Review and Synthesis", *The Yale Journal of Regulation*, Vol. 8, No. 1, 1991.

7. For a discussion of these models see Hahn and Hird, 1991.

### 3. What is a Good RIA and How Can it Be Helpful?

A RIA is simply a way of gathering and organising information about the expected impacts of a law or regulation and its major feasible alternatives. In its simplest form it can be a list in qualitative terms of the expected positive, negative and indeterminate impacts of the intended action. In its more sophisticated form a RIA can be a rigorous benefit cost analysis, sometimes using a large scale econometric model of the economy, with input from economists, engineers, and scientists and other experts. The RIA will also detail in quantitative terms the net benefits to society (social benefits minus social costs), along with the distributive effects of the intended government action and its feasible alternatives. In between these two extremes, a RIA may provide information on certain impacts but not others. For example, Austria's and Iceland's guidance call for fiscal analyses of the impacts of regulations and the United Kingdom's, a business cost analysis<sup>8</sup>. RIAs are not meant to be simple decision formulas whereby you plug in the numbers and get an answer. Rather, every country that uses them including the United States uses them as one of several factors that go into the final decision. Other less empirical factors that may feed into the decision-making include political and constitutional considerations, international treaty obligations, and expert opinion.

As mentioned above, the United States and most other countries with RIA requirements do not put the same time and effort into each RIA. Rather they are tailored to the magnitude of the problem being addressed by the law or regulation. If the regulation writers have no discretion to change the regulation in a material way, there is little immediate payoff to producing an elaborate RIA. In this case, a simple statement of expected favourable and unfavourable effects should be listed. A more complete ex post evaluation of the impact could be done sometime later. However, the requirement of doing a RIA should not be completely ignored because it is important to have a standard of expected effects against which to judge the results of the ex post evaluation and because it is generally easier to change a policy before it is implemented than after it has become entrenched.

RIAs are helpful because they provide a systematic set of information which decision-makers can use to make informed comparisons and choices among alternatives. But RIAs are more helpful in their advanced form when they use economic theory to forecast impacts on competition and benefit cost analysis (BCA) to inform decision-makers about what alternatives are likely to be most cost effective for society. BCA is also useful in estimating the distributive impacts, i.e. who gains and who loses from the regulation.

The BCA part of such a programme was recently endorsed by a panel of eleven prestigious economists including a Nobel prize winner in economics, Kenneth Arrow. The recommended programme was also published in one of the top US scientific journals, *Science*. Using economic theory to predict the impacts of government policy on competition has long been accepted by economists of all persuasions. The panel concluded:

Benefit-cost analysis can play an important role in legislative and regulatory policy debates on protecting and improving health, safety, and the natural environment. Although formal benefit cost analysis should not be viewed as either necessary or sufficient for designing sensible public policy, it can provide an

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8. See Table 1 of "An Overview of Regulatory Impact Analysis in OECD Countries: Note by the Secretariat", PUMA/REG(96)7, OECD, May 1996.

exceptionally useful framework for consistently disparate information, and in this way, it can greatly improve the process and, hence, the outcomes of policy analysis<sup>9</sup>.

The next section discusses the principles recommended for RIAs by the Arrow group and how certain countries, such as the United States, Canada, Australia and some of the state governments of these countries have adapted such principles to their own needs.

#### **4. Basic Principles of a High Quality RIA**

As is evident from the Arrow statement, the RIA programme that is strongest analytically and contains the most complete information relevant to improving the economic well being of a country's citizens is benefit-cost analysis or BCA for short. BCA is based on the early theoretical work of French and English economists and was first extensively applied in the United States in the 1930's in evaluating water projects. In the 1960's it was used to evaluate national defence spending. In the early 1970's its use spread to evaluating social programmes like education, housing, agricultural, import protection and job creation. And in the late 1970's and early 1980's its use spread to the regulatory area, first in the United States, and then in Canada, Australia and other OECD countries. The World Bank also makes extensive use of BCA in allocating its investment funds to projects around the world. For example, the World bank recently completed a BCA for the Kunda Cement Factory in Estonia that found that the social benefits that may accrue to the population from curbing pollution exceed private costs by a margin that sufficiently justifies the environmental investment<sup>10</sup>.

The theoretical basis for BCA rests on the academic field known as "welfare economics" and has several basic assumptions: that people can value alternative actions in meaningful ways; that these actions can be meaningfully aggregated across individuals in some common unit of value such as dollars; and that society should take actions that maximise these values for all its members.

Economists call the value people put on alternative actions or outcomes their willingness to pay for it or their WTP, for short. Since the opportunity cost of a particular action is the next best action that no longer can be taken, the WTP for that alternative is the opportunity cost intended action. A government action that maximises the WTP of the action, minus the WTP of the cost of that action aggregated across all individuals, maximises the net welfare of society. For example, an individual buys a product because his or her WTP for it is greater than its price<sup>11</sup>. The greater one's WTP relative to its price or cost, the greater the benefit one derives from the action. Economists call this difference, "consumer surplus." To apply this construct to a government action such as prohibiting the sale of leaded gasoline, the aggregate of individuals' WTP for healthier and more intelligent children is compared to the extra ten cents or so per liter of gasoline that unleaded gasoline costs over leaded gasoline. The estimate of the benefits to children

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9. Kenneth J. Arrow, Maureen L. Cropper, George C. Eads, Robert W. Hahn, Lester B. Lave, Roger G. Noll, Paul R. Portney, Milton Russell, Richard Schmalensee, V. Kerry Smith, and Robert N. Stavins, "Is There A Role for Benefit-Cost Analysis in Environmental, Health, and Safety Regulation", *Science*, 12 April 1996.

10. See Yannis Karmokolias, "Cost Benefit Analysis of Private Sector Environmental Investments: A Case Study of the Kunda Cement Factory", The World Bank, *IFC Discussion Paper No. 30*, 1996.

11. Note that the WTPs for amounts of a product, action, or service trace out the demand curve.

must exceed the extra costs to motorists of unleaded gasoline for the government action to produce net benefits for society.

The major weakness to this approach is that an individual's WTP depends on his or her level of income, which can differ significantly, and often unfairly, across individuals. That is why a BCA is not complete without a careful analysis of just who gains from a government action and who ends up paying for it. If low income people are the losers and high income people are the winners from the government action, the conclusions of the net benefits calculation should be carefully considered by the decision-makers in light of this undesirable side effect. In the above example, since the beneficiaries of banning leaded gasoline, the children who play near the streets, are most likely of lower income than the motorists who bear the costs, the distribution analysis would not likely affect the conclusions of the benefit-cost calculation.

The Arrow group has produced seven principles that they recommend that governments considering legislative or regulatory actions make use of:

- i) Benefit-cost analysis is useful for comparing favourable and unfavourable effects of policies.
- ii) Decision-makers should not be precluded from considering the economic costs and benefits of different policies in the development of regulations. Agencies should be allowed to use economic analysis to help set regulatory priorities.
- iii) Benefit-cost analysis should be required for all major regulatory decisions.
- iv) Although agencies should be required to conduct benefit-cost analysis for major decisions and to explain why they have selected actions for which reliable evidence indicates that expected benefits are significantly less than expected costs, those agencies should not be bound by strict benefit-cost tests.
- v) Benefits and costs of proposed policies should be quantified where ever possible. Best estimates should be presented along with a description of the uncertainties.
- vi) The more external review that regulatory analyses receive, the better they are likely to be. A core set of economic assumptions should be used in calculating benefits and costs. Key variables include the social discount rate, the value of reducing premature death and accidents, and the values associated with other improvements in health.
- vii) Although benefit-cost analysis should focus primarily on the overall relation between benefits and costs, a good analysis will also identify important distributional consequences<sup>12</sup>.

Several countries have implemented the Arrow group's principles by producing detailed guidance documents that explain how to do the analysis called for by these principles. According to a recent paper prepared for OECD/PUMA by Professor Thomas Hopkins who surveyed the RIA guidance documents of the OECD countries, the US guidance, *Economic Analysis of Federal Regulations Under Executive Order 12866*, issued on 11 January 1996, by the Office of Management and Budget, is the most comprehensive

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12. Arrow *et. al.*, 1996, pp 221-222.

and analytically sophisticated<sup>13</sup>. He also pointed out that Canada's document, Benefit-Cost Analysis Guide (May 1995) and Australia's document, A Guide to Regulatory Impact Statements (September 1995) were also fairly comprehensive while being easier for non economists to understand. Countries interested in developing their own RIA guidance adapted to their needs and special circumstance might find it useful to start by reviewing these documents.

## 5. How to Do A RIA: The US Guidance

The principles and details of the US programme can be found in Executive Order 12866, issued by President Clinton on 30 September 1993<sup>14</sup>. A 37 page guidance document (which is available on the internet on OMB's home page) implements the Executive Order and consists of three sections and a recommended reading list of mainly academic books and articles<sup>15</sup>. The guidance document is used for both ex ante impact assessments of proposed regulations and legislation and ex post evaluations of existing regulations although it is generally written as if the regulations are proposed. The guidance document states that RIAs, now called Economic Analyses in the United States, should provide decision-makers with information to determine that:

- There is adequate information indicating the need for and the consequences of the proposed action;
- The potential benefits to society justify the potential costs, recognising that not all benefits and costs can be described in quantitative terms, unless a statute requires another regulatory approach;
- The proposed action will maximise net benefits to society ..., unless a statute requires another regulatory approach;
- Where a statute requires a specific regulatory approach, the proposed action will be the most cost-effective, including reliance on performance objectives to the extent feasible;
- Agency decisions are based on the best reasonably obtainable scientific, technical, economic, and other information<sup>16</sup>.

### 5.1. Statement of Need

The first section of the guidance document explains how to prepare a statement of need for a proposed government action. The basic assumption of BCA drawn from the first theorem of welfare economics is that perfectly competitive markets will maximise net benefits to society. The problem is, of course, that

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13. See Thomas D. Hopkins, *Alternative Approaches to Regulatory Analysis: Designs From Seven OECD Countries*, PUMA/REG(96)5, OECD, May 1996.

14. The Order may be found in the US *Federal Register*, Vol. 58, No. 190, 4 October 1993, p. 51735.

15. The following is from *Economic Analysis of Federal Regulations* under Executive Order 12866, Executive Office of the President, Office of Management and Budget, 11 January 1996.

16. *Economic Analysis*, p 1.

many markets are not perfectly competitive. But that means that if the government can identify those markets that are not perfectly competitive, it may be able to correct the market failure and improve society's welfare. Thus the statement of need examines systematically whether there is a market failure that might justify government intervention. There are four main reasons why markets may not be perfectly competitive:

- a) A natural monopoly may exist where a market can be served at lowest cost only by one producer. Examples include gas, electricity, and water distribution services.
- b) Market power may exist where the firms in an industry conspire to lower output below what a competitive industry would sell and thereby raise prices collectively or unilaterally. A government action itself could cause this to happen by restricting entry into an industry to just a few firms or using trade restrictions to keep out foreign imports.
- c) An externality or spillover may exist where one party's actions impose uncompensated benefits or costs on another. Pollution is the classic example and indeed is a major reason for the increase in regulation in OECD countries. Other examples include the problem of the "commons" where over use of common or public resources such as land, fisheries and the broadcast spectrum becomes harmful.
- d) Inadequate or asymmetric information between market participants can also cause markets to fail although perfect information is not desirable either, because information itself is costly. This is one of the trickiest market failures to analyse.

Because government action is often harmful to competitive markets, the following types of regulations should be carefully examined to make sure that there is a real need for them<sup>17</sup>:

- a) Price controls in competitive markets.
- b) Production or sales controls in competitive markets.
- c) Mandatory uniform quality standards for goods and services unless there are hidden safety concerns.
- d) Controls on entry into employment or production except where there are real safety concerns, e.g. airline pilots, or they are needed to manage common property resources, e.g. fisheries, airwaves.

Even if there is a market failure as listed above, there may be other ways to deal with the problem than through regulation, such as the judicial system, antitrust enforcement, or taxes to discourage the use of a product that produces a harmful externality such as leaded gasoline or alcohol. In addition since some market failures may be caused by past regulations, especially government restrictions on competition, consideration should be given to changing existing government regulations. Finally, there may be important reasons other than economic benefits that justify regulations even when there is no significant market failure. These reasons may be the distribution concerns mentioned above or political or foreign

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17. The state of Queensland in Australia has a list of 11 types of regulations and legislation that it uses to screen for anti-competitive effects. See Sue Holmes and Steven Argy, *Reviewing Existing Regulations: Australia's National Legislative Review*, PUMA/REG(96)3, OECD, May 1996.

policy concerns. For example, there may be a consensus that the market outcome although efficient is not “fair” or “just”. These situations should be carefully examined, however, because they are often used to favour “special interests” and not necessarily, deserving interests.

## 5.2. *Examination of Alternatives*

The second section of the US Guidance document advises that analysts should examine the most important feasible alternatives to the main regulatory proposal. The number of alternatives actually examined depends upon the amount of time and resources that can be spared for the analysis and how valuable the analysis is likely to be. The types of alternatives that should be considered can be divided into categories:

- a) *More Performance-Oriented Standards.* Performance standards are generally to be preferred to more specific engineering or design standards because they give firms or individuals the flexibility to comply with the regulation in the most cost-effective way. In other words the more ways the regulation allows the regulated parties to comply with the regulation the better as long as the performance goal desired by the government is met. For example, an industrial plant’s air emission’s standards should be set on a plant or firm wide basis rather than vent by vent.
- b) *Different Requirements for Different Segments of the Regulated Population.* The net benefits of regulations can often be increased if the stringency of regulations is varied according to the variance in costs per given amount of benefit produced for different segments. For example if small firms find it more costly to comply with a regulation than large firms even though the amount of benefits produced is the same, then it would be more cost effective to place less stringent requirements on the small firms than the large firms. This principle also can be applied across industries, geographic areas, or even countries. This principle often leads to the conclusion on economic efficiency grounds that more developed countries should have more stringent health, safety, and environmental regulations than less developed or transitional countries. Both the WTP of developed countries may be greater for environmental amenities because of their higher incomes and the cost of compliance may be less because of their more developed infrastructure and their head start in compliance with these types of regulations. A variant on the different stringency approach is to give different segments different time periods to come into full compliance. Thus less developed countries could be given more time to come into compliance with certain regulations than the developed countries.
- c) *Informational Measures.* This alternative should generally be used to correct market failures that are caused by inadequate or asymmetric information. These measures include the government establishing standardised testing or rating systems, government provision of the information itself, or a requirement that firms disclose certain types of information through labelling, advertising, or mandatory disclosure documents. For example, to reduce energy consumption the government could mandate that certain appliances such as refrigerators or heating systems meet specific energy usage levels or it could require that easy to understand energy efficiency levels that estimate the energy use and cost of the appliance be labelled on the appliance. Assuming there are no significant externalities associated with buying a less energy efficient appliance, it is more cost beneficial to inform the consumer about energy costs and let him or her buy

the right combination of durability and operating costs suitable for his or her own needs and circumstances.

- d) *More Market-Oriented Approaches.* In general, alternatives that provide for more market-oriented approaches such as user charges, pollution charges, marketable permits and establishing property rights are more cost-beneficial than command and control regulations. These systems harness the market system and competition to further public goals. For example, just as establishing property rights to land has been shown to increase the efficiency of agriculture, assigning property rights or marketable permits to such diverse items as fishing quotas, airwave spectrum, water rights and clean air should also conserve on resources and direct them to their most highly valued uses. Over-fishing in New Zealand fisheries was threatening to lower certain New Zealand fishing stocks below the sustainable stock until Individual Transferable Quotas (ITQ's) were assigned to commercial fisherman based on the average of previous years' catches<sup>18</sup>. The government then bought back enough ITQ's to lower the catch to sustainable levels. The United States has also been auctioning off its air waves spectrum to the highest bidder for cell phones and personal communication devices and allowing electric utilities to trade permits that allow firms to emit a certain number of tons of sulphur per year. The permit to pollute system allows a firm who find it very costly to reduce emissions to buy permits from a firm that found ways to do it more cheaply, thereby increasing the profits of both firms and reducing the total costs of meeting the given level of pollution.

### 5.3. *Benefit-Cost Analysis*

The Guidance's last section explains how to do the actual benefit-cost analysis of the proposed regulation and its main alternatives. It in turn is divided into three subsections: General Principles, Benefit Estimates and Cost Estimates.

#### 5.3.1. *General Principles*

The first topic addressed in the General Principles subsection is the baseline. The benefits and costs of each alternative must be measured against a baseline of the case without regulation. In general for the case of a proposed regulation, the baseline is the existing situation. For an ex post evaluation of an existing regulation, the baseline should be the world without the regulation.

A second important principle is applied when costs and benefits occur in different time periods. In that case both costs and benefits in constant dollars, i.e. adjusted for inflation, should be discounted to the present using the same discount rate. The United States OMB's guidance which also applies to budget calculations states that a 7 per cent real rate should be used unless a strong case can be made that another rate might be appropriate. In that case, the 7 per cent rate is still used and the results from using the alternative rate are presented in a sensitivity analysis. There is also a discussion that explains why a different rate might be more appropriate in certain circumstances.

Since the effects of regulations are almost always uncertain, risk analysis techniques must often be used. The basic principle here is that risk assessments should be guided by full disclosure and transparency.

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18. For a discussion of the use of marketable fishing rights see Francois Lacasse, *The Lessons From Success: Markets in Fishing Rights*, Market-Type Mechanism Series No. 3, OECD, 1992.

Where probability distributions are available, expected values should be used. Unstated preferences for protecting the environment or public health should not be built into assumptions unless explicitly acknowledged. Otherwise these assumptions tend to accumulate and decision-makers don't know how much of a margin of safety they are buying. Results should also be presented with some estimate of their degree of uncertainty. A list of techniques for handling uncertainty where the probability distributions are unknown include Monte Carlo analysis and other simulation techniques, sensitivity analysis where assumptions are varied and "switching points" are calculated, Delphi methods used by a group of experts, and meta-analysis that combines data from different studies on the same topic.

US guidance also recommends that when estimating the costs and benefits of regulations that have international trade effects, no explicit determination should be made between domestic and foreign resources. For example, if a regulation requires the purchase of specific equipment it doesn't matter whether it is produced inside or outside the United States. As long as the foreign exchange market determines the value of the currency, the opportunity costs of the equipment is the same. Obviously exchange controls can introduce complications.

Where costs and benefits can not be monetized, they should at least be quantified. If they can not be quantified they should be described in qualitative terms. Data should not be allowed to drive the conclusions if important parts of the analysis are unquantifiable. Full consideration must be given to these effects as best can be done by the decision-makers.

Finally the distributional effects, who gains and who loses, from the regulation should be estimated and presented. There are no generally accepted techniques for including these effects directly in the benefit-cost calculations, although some people suggest giving different groups different explicit weights in the analysis (not doing that assigns equal weights across all groups).

### 5.3.2. *Benefits Estimation*

The second subsection presents guidance on how to estimate the benefits of the regulation. In some ways this is the key innovation of BCA. Other systems of impact analysis concentrate on the cost side since costs are generally easier to measure and benefits are unspecified but assumed to be large. Historically in the development of RIAs, estimation of costs was the first "impact" to be implemented. Moreover most budgetary systems today track the costs of government spending and pay little attention ex ante to the benefits of government spending in any monetized or comprehensive way. However, knowing the benefits, if any, of a government action is just as important as knowing the costs.

The first step in benefit estimation is to determine the mechanism by which the government action is supposed to improve the public's welfare. Attempts should be made to quantify all potential real incremental benefits to society in monetary terms to the maximum extent possible. Ideally a schedule of the type of benefit, when they are expected to occur and to whom should be included. Any benefits that cannot be monetized such as an increase in the rate of introducing more productive technology or an increase in national security should be carefully described and explained. The RIA should also identify and explain the data or assumptions on which the benefit estimates are based, so that the results could be reproduced by an independent reviewer.

As discussed above, the concept of "willingness to pay" (WTP) is the basis for valuing benefits and costs of government actions. Market transactions provide the richest data base for estimating WTP. However in some cases market value does not reflect the true value to society. In those cases a "shadow price" should be used. Those cases occur when market prices are not competitively determined but are, for example,

fixed by the government. If the government controls energy prices below the international free market equilibrium, then the free market price is the “shadow price” and should be used in the BCA.

Many goods or services are not traded in markets. Their benefits must be estimated indirectly by simulating at what price they would trade if they could be traded in a market. Statistical techniques, often multiple regression analysis, have been developed to indirectly measure the WTP of such goods and services. For example, time-travel studies have been used to estimate the WTP for new recreational areas. Hedonic price studies have been used to estimate the increased value of land that results when local pollution such as noise from aircraft is reduced or hazardous toxic waste dumps are cleaned up. And labour market studies estimating the compensating wage differential demanded by informed workers in free markets for working in risky jobs have been used to estimate the value of improving safety conditions. Finally where markets cannot be simulated by statistical techniques, survey techniques involving questionnaires administered to potential beneficiaries of the government action have been used. This method, known as the “contingent-valuation” method, is very sensitive to how the questions are asked and must be very carefully used. In the US contingent-valuation methods have been used to measure the benefits of reducing the particulate emissions of power plants that during certain weather conditions cloud the view of the Grand Canyon in Arizona.

A large amount of research has been done to estimate the benefit to society of reducing small incremental risks of death spread over a large number of people. In this situation, as opposed to a large risk for a single individual, statistical techniques and economic theory have allowed researchers to estimate fairly reliable and robust numbers. Using US data, Professor Viscusi, an economist at the Harvard Law School, has estimated that workers are willing to pay between US\$3 000 and US\$7 000, with a midpoint of US\$5 000, for a reduction in the risk of death of one in a thousand. For a thousand people using the midpoint, that amounts to US\$5 million per statistical life extended<sup>19</sup>. This estimate can then be compared to cost per life saved calculations (cost of the regulation divided by the number of expected lives extended) of various proposals to save lives through regulatory actions to determine which regulations pass a benefit-cost test. The cost per life saved estimates for proposed regulations can also be compared to the cost per life saved estimates for regulations that have already been issued to determine whether the proposed regulations are cost effective relative to existing regulations. Using this approach, one study of US regulatory experience found a wide variance in the cost per life saved of various regulations<sup>20</sup>. Many regulations that had been issued passed the benefit-cost test but many others did not. In particular regulations aimed at safety concerns, such as highway safety, were significantly more cost-effective than regulations aimed at health risks caused by carcinogenic chemicals. The cost per life saved ranged from US\$100 000 for automobile steering column protection to US\$119 billion for occupational control of formaldehyde<sup>21</sup>. If the US\$162 million annual cost of the formaldehyde regulation had been shifted to compliance with a safety regulation as cost-effective as the steering column protection regulation, almost 1 620 more people could have been saved per year with the same expenditure on costs.

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19. See W. Kip Viscusi, “The Dangers of Unbounded Commitments to Regulate Risk” in Robert W. Hahn (ED.) *Risks, Costs, And Lives Saved: Getting Better Results From Regulation*, Oxford University Press, 1996.

20. John F. Morrall III, “Regulating Risks: A Review of the Record”, *Regulation*, November/December 1986. Also see Table 3 in John F. Morrall III, *Controlling Regulatory Costs: The Use of Regulatory Budgeting*, OECD, 1992, which contains updated information on the cost per life saved of 37 regulations.

21. Morrall, 1992.

### 5.3.3. Cost Estimation

The third subsection describes how to estimate the costs of regulation. The basic methodological points made about benefit estimation such as the importance of transparency, objectivity, and reproducibility of results, also apply to cost estimation. The basic concept of costs is the idea of opportunity costs, the benefits foregone as a result of the regulatory action. Opportunity costs include but are not limited to private sector compliance costs, government administrative costs, and consumers' and producers' surplus losses. Consumers' surplus loss refers to the difference between the demand curve, i.e. what consumers would be willing to pay for various quantities of goods or the WTP schedule and the actual price charged. Producers' surplus refers to the difference between the supply curve, i.e. what the producers would be willing to accept for their product, and the price they actually receive. Thus the opportunity cost of banning a product or not allowing a license for a new business is the sum of the losses of consumers' and producers' surpluses.

An important but sometimes difficult problem in cost estimation is how to distinguish between real costs and transfer payments. Transfer payments are not real costs to society because they are made by one group in society to another. In effect they are similar to government social insurance payments and unlike government spending on bridges or salaries of government workers, which represent real costs to society and which also produce real benefits to society. Monopoly profits, scarcity rents, insurance payments, sale of government assets, subsidies and taxes are all examples of transfer payments that should be listed but not included in the BCA calculations.

The above guidance, including earlier editions, for doing BCA has been used by the United States for the last fifteen years. During that time over 500 regulations with impacts of over at least a US\$100 million each have been subject to BCA. During that time three Presidents from both major political parties have renewed their commitment to the use of BCA to improve the efficiency and fairness of government. The next section will briefly describe how the programme developed and how it is currently organised in order to determine what lessons can be learned from the US experience.

## 6. Development of the US Regulatory Review Programme<sup>22</sup>

The US Regulatory review programme is characterised by strong central government oversight. OMB, which is the largest office in the Executive Office of the President oversees both the US\$1.3 trillion budget of the United States and an estimated US\$600 billion of regulatory costs. As such it wields considerable influence over the governance of the United States. Other government agencies who legally issue regulations are required to do the supporting RIAs and the US Congress who pass legislation that the Presidents signs into law usually pay close attention to OMB recommendations. The US regulatory review programme with its relatively sophisticated RIA requirements and strong oversight by OMB works fairly well.

However the US RIA programme was not always as sophisticated and did not start out with a strong central oversight structure. Nor as a consequence was it always as effective as it is now. In the early 1960s, the programme consisted mainly of the Commerce Department presenting the business community's views about regulations. As mentioned above, the economic difficulties of the stagflation of the middle 1970s that was produced by the oil shock led to the creation of a new government agency—the

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22. This section briefly summarizes John F. Morrall III, *An Assessment of the U.S. Regulatory Impact Programme*, PUMA/REG(96)10, OECD, May 1996.

Council on Wage and Price Stability (CWPS) — to review and publicly comment on regulations and to a requirement that agencies analyse the inflationary impact of government regulations. This first review group had a staff of about six mostly Ph. D. economists drawn from academia on temporary assignment. However there was no real central government oversight since CWPS could do no more than present its views in writing during the regular public comment period on the RIAs the line departments prepared. Although toward the end of the 1970s during the Carter Administration the RIAs evolved into BCAs and the staff had grown to about twenty, the line agencies ignored most of the comments from CWPS.

However the agencies who had to prepare the analyses did pay some attention to them especially when major flaws were pointed out. Regulations were probably more cost-effective than they otherwise would have been. This was also the period in the United States when the Congress and the President were beginning to deregulate airlines, trucking, railroads and communications. The success of the deregulation movement and the record of the public comments that CWPS was building against inefficient regulation set the stage for the more aggressive and effective regulatory reform programmes of the 1980s and 1990s.

President Reagan made regulatory relief one of the four pillars for economic growth in his 1980 campaign. After he took office in 1981, he introduced a programme that went far beyond previous programmes in its centralisation of control and its requirement for sophisticated economics-based RIAs. Despite the hostility it engendered from the opposition party, when they took control 12 years later they adopted with some modifications the same basic model. The programme requires that all regulations developed by the line departments be sent to the Office of Management and Budget (OMB) before they can be put out for public comment and again before they are issued in final form. Furthermore the agencies had to assure to the extent permitted by law that the benefits of the regulation exceeded the costs. To show this for major regulations, generally those regulations whose costs exceeded US\$100 million in effect on the economy per year, the departments and agencies had to prepare a RIA that followed the basic BCA principles of the guidance document described above. Finally OMB reviewed the regulations and the RIAs and presented its recommendations to the agency. If the agencies did not agree with OMB's recommendations, the Vice President was asked to convene a high level group to decide what to do. In practice this model gave the OMB considerable authority to influence the final outcome.

President Clinton fine tuned this basic model when he replaced President Bush in 1993. Since there had been considerable criticism that the Vice President who was in charge of the programme on a day-to-day basis had politicised the process and delayed regulations, President Clinton implemented changes to correct those perceived problems. First, the Clinton regulatory review programme concentrates OMB's efforts only on the most important regulations. The Office of Information and Regulatory Affairs, the group within OMB that reviews regulations has a staff of about 40 economists, policy analysts and lawyers who review about 900 regulations per year, of which 15 per cent are major rules that are accompanied by RIAs. Another 200 budget examiners in OMB also review these regulations to determine their impact on government spending and the budget and report their findings to OIRA. Second, the President increased the transparency of the review programme by requiring that a) contacts with outside parties about regulations under review be recorded and open to the line agencies, b) written information received from outside parties be kept in files open to the public, and c) the list of regulations under review be made public, including placing it on the internet in real time. Third, the President required OMB to complete review of regulations within 90 days and if there was still disagreement between OMB and the line agency at that point to submit the differences to him or the Vice President acting on his behalf. Finally, the new Administration raised the visibility given to distributional effects and intangible concerns, such as equal opportunity, fairness, and other fundamental rights. Currently there is strong support for this programme by both political parties and the controversy that the Bush programme had

engendered has disappeared. In fact the debate in the United States today is about how to strengthen and extend the regulatory review programme through new legislation<sup>23</sup>.

There have been several evaluations of the US programme over the last few years that in general have confirmed its effectiveness, although no real benefit-cost analysis of the programme has been done to date. A study by Robert Hahn of the American Enterprise Institute in Washington which reviewed the RIAs that had been done since 1990 found that the regulations issued over that period were projected to produce net present value benefits for the US economy of US\$280 billion, although another US\$140 billion could have been produced if certain regulations whose costs exceeded benefits had not been issued<sup>24</sup>. Another study done for the OECD, calculated that if the RIA programme increased benefits and reduced costs by just 1 per cent up to US\$156 million could be spent per RIA and the programme would still have produced net benefits for society<sup>25</sup>. Finally, the Arrow report discussed above also looked at the use of BCAs in US regulatory oversight programme and strongly endorsed the continued use of BCAs.

## 7. Other OECD Countries' Regulatory Review Programmes

The US pattern of starting with a simple regulatory review programme with modest RIA requirements that evolves toward stronger oversight and more comprehensive RIA requirements is being repeated in other OECD countries. According to an OECD study, after the United States' RIA programme was started in 1974, Canada and Finland followed in the late 1970's and Germany, Australia, the United Kingdom, the Netherlands, Japan, Sweden, and Norway in the mid 1980's<sup>26</sup>. All of these countries have added requirements and refinements since then and Iceland, Portugal, and New Zealand started programmes in the 1990's. In addition several states in the United States and Australia have adopted programmes. Since the Council of the OECD on Improving the Quality of Government Regulation, on 9 March 1995, endorsed the use of RIA programmes and organisations to improve the quality of regulations, it is likely that other OECD countries will introduce regulatory review programmes and that the existing programmes mentioned above will continue to be improved.

Australia and Canada have developed relatively advanced programmes that offer clear instructions to government officials who are not economists on how to do the BCA that is required. Canada in fact offers training sessions, software programmes, and two separate sets of guidelines, one for major regulations and one for non major regulations, to the line agency government officials who do the analyses. Australia and several of its states have particularly good programmes and instructions to screen both primary and subordinate legislation that could restrict competition or confer advantages on certain market participants over others<sup>27</sup>.

Several countries' programmes focus their RIAs and programme orientation on just part of the information on regulatory impacts that is needed to make a fully informed decision. Nevertheless this type

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23. See Morrall, pp. 7-8, 1996.

24. See Robert W. Hahn, *Regulatory Reform: What Do the Government's Numbers Tell Us?* In Hahn, ed., 1996.

25. Morrall, p. 10, 1996.

26. See *Overview of Regulatory Impact Analysis in OECD Countries*, Note by the Secretariat, PUMA/REG(96)7, OECD, May 1996.

27. For example see Holmes and Argy, 1996.

of programme is a good beginning and partial but important information is usually better than no information. For example, Portugal and Iceland have formal requirements for analysing the impact of regulation on the government's budget although there are proposals to broaden the analysis to include the cost impacts on the private sector as well. The Netherlands' programme is specifically designed to analyse the consequences of draft legislation, general administrative orders and ministerial decrees on businesses. There is no analytical requirement to look at the effects on consumers, workers or the public at large. The instructions also state that "EU directives where no national discretion exists are not covered"<sup>28</sup>. Several other countries including the United Kingdom, Germany, Sweden, and Norway, although focusing on the cost impacts on business, ask that analyses be extended to a full BCA in certain circumstances, such as where the impacts are very large or wide spread.

## **8. The OECD Checklist for Regulatory Decision-Making**

As mentioned above, the Council of the OECD has recommended that regulatory programmes be set up as a way to establish conditions for sustainable global economic growth. Specifically the OECD council recommended: "that member countries take effective measures to ensure the quality and transparency of government regulations by steps such as ... developing—as far as practical and in conformity with legal principles and governing traditions—administrative and management systems through which principles of good decision-making...will be reflected in regulatory decisions..."<sup>29</sup>. The OECD council also listed ten questions as a check list that many OECD countries already use and for others to adopt that should improve the efficiency and effectiveness of government regulations. The ten questions are:

1. Is the problem correctly defined?
2. Is government action justified?
3. Is regulation the best form of government action?
4. Is there a legal basis for regulation?
5. What is the appropriate level (or levels) of government for this action?
6. Do the benefits of regulation justify the costs?
7. Is the distribution of effects across society transparent?
8. Is the regulation clear, consistent, comprehensible, and accessible to users?
9. Have all interested parties had the opportunity to present their views?
10. How will compliance be achieved?

These questions in some ways go beyond what was emphasised above in the discussion about the US programme, however, they are asked one way or another in the US regulatory review and RIA programme. As mentioned above, question six on BCA is given more weight in the US system than in most other OECD countries' programmes. As an overall blueprint, the principles these questions represent form a good starting point on which to build an effective RIA and regulatory review programme both for OECD countries that do not have such programmes and for other countries that are concerned about regulatory quality. Along with the Arrow principles and the US RIA guidance discussed above, most of what is needed to establish a first class regulatory review system has been listed. What remains is adapting

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28. Hopkins, p. 11, 1996.

29. *Recommendations*, OECD, 1995.

these general principles and instructions to individual country differences in needs and institutions. In other words, the hard part. The following is meant to help in that effort.

## 9. Lessons Learned for Setting Up RIA Programmes for Countries in Transition

*RIA Programmes Have the Potential to Improve Economic Performance.* Improving economic performance is the motivating factor that caused most OECD countries to set up their original RIA programmes. The fact that most OECD countries expanding their programmes collectively through the OECD have endorsed the concept of a RIA programme indicates that OECD countries believe that RIA programmes have been effective. The few evaluations of RIA programmes that have been done also give credence to the conclusion that these programmes do offer net benefits to the economy and citizens of the countries that do have such programmes. The fact that governments with smaller economies such as Tasmania, Queensland and Victoria in Australia, and Iceland, Portugal, the Netherlands and New Zealand have adopted RIA programmes indicates that RIA programmes are beneficial to smaller as well as larger governments<sup>30</sup>.

*Start with Small Steps.* No country has started a RIA programme with a full scale BCA requirement tightly administered by the centre of government. Rather the first steps have been toward RIAs that examine only the most important impacts and not always with sophisticated quantitative techniques. Systematic thinking and recent economic learning and experience can offer useful insights about the likely impacts of many proposed regulations.

*Focus on Major Regulations at First.* Most countries have a triage system that fits the amount and level of analysis to the expected size and importance of the regulatory impact. Clearly analysis for analysis' sake is counterproductive.

*Have an Open and Transparent System.* In the long run closed systems fail in a democracy. Closed systems do not engender the political support needed to keep such programmes viable. The US programme in the Bush administrations came under such criticism about behind the scenes business influence that it was almost not continued by the next Administration. A programme has to be seen as fair and impartial to have much hope of being continued when governments change.

*Aim High But Be Flexible.* It is important to know what high quality analysis is and why it can provide the maximum benefit to the economy. Only a RIA programme of the type recommended by the Arrow panel of experts and the OECD Council on Improving the Quality of Regulation is likely to realise the full gains to the economy that regulation can produce. This type of framework should be the long term goal even if it is not feasible or even desirable to apply it in most situations. Small steps may be necessary at first, but one also needs to know where one is going.

*Have the Line Agencies Prepare the RIA.* Almost all countries have the line agencies prepare the RIA. In most cases it makes more sense to have the people who are most knowledgeable about the substance of the proposal do the analysis and have the experts in analysis consult with them and review the analysis. Usually the line agencies have more resources to do the RIAs and prefer to do it themselves in any case. However until the line agencies develop the expertise necessary to do the analyses they are likely to need considerable help from analysts trained in microeconomics located at the government centre or in a regulatory review group. Training programmes and outside consultants have also been found to be helpful.

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30. See *Overview*, OECD, 1996.

Making preliminary RIAs public and having affected parties comment on them should also improve their quality and usefulness.

*Have Expert Analysts at the Centre of the Government Review the RIAs.* The same reasoning that suggests that budget estimates prepared by line agencies should be reviewed by a budget office at the centre of government, also suggests that RIAs prepared in support of regulations by the regulating agency should be reviewed by a regulatory review office at the centre of government. The reasoning is that line agencies tend to be self-interested in expanding their programmes whether through government expenditures or regulatory mandates and private expenditures. In general the government officials located at the centre will have a broader and more objective perspective that realises that societies resources are limited and trade-offs must be made among differing demands. Furthermore an office located at the centre reporting to the President or Prime Minister is likely to have the authority or credibility to enforce its recommendations. The reviewers of RIAs will also likely over time develop the experience and perspective that should make them better reviewers.

*Be Patient. It Takes Time to Build an Analytical Infrastructure.* The establishment of modern regulatory review requirements should be viewed as a long term commitment. Even countries that began their RIA programmes 20 years ago are still making improvements or refinements to their programmes. There appears to be a continuing movement by OECD countries toward expanding the use of BCA and tightening the central government's control over the regulatory actions of the line agencies. Countries that do not start RIA and regulatory programmes now may have to play catch up later. The international financial markets and institutions such as the OECD, the International Monetary Fund and the World Bank increasingly view regulatory reform and management as important indicators of a country's long term growth prospects and financial stability.

## **10. Future Considerations**

Even the most advanced regulatory review programmes have not stopped evolving and improving. Some countries have talked about the next step as being one of integrating the regulatory process into the fiscal budget process. Since regulations can order firms or parties in the private sector to make expenditures for public purposes without going through a budget control process, there is a natural tendency when budgets are tight and deficit reduction a primary goal to substitute regulation for government expenditures. It is a way to go "off budget" and still provide for the public's demands for government action. Since there is little difference in the economic effects of ordering a firm to spend its money for a public purpose such as waste water treatment or an individual to buy health insurance and the government's taxing or borrowing from the same firms and individuals to provide the same services, it may make sense to control both government policy tools in a similar fashion. Just as a fiscal budget sets annual government spending targets, a regulatory budget could set annual regulatory spending targets. However, because it is thought to be more difficult to estimate what the private sector would spend to comply with regulations than it is to estimate what the government spends, implementation of the regulatory budget awaits the development of better regulatory cost estimation techniques<sup>31</sup>.

Because of political concerns, some governments find it difficult to do BCA for regulations that involve saving lives. It is difficult to explain the difference between saving a "statistical life", i.e. reducing incremental risks for a large number of people, and saving the life of an identified person. One can argue

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31. For a discussion of the pros and cons of the regulatory budget and its use in the US see Morrall, 1992.

that it is immoral in the latter case to stop short of saving a life for cost reasons. But one can argue that it is immoral in the former case not to consider the cost of saving “statistical lives” because with limited resources for saving lives not to consider costs means that fewer lives could be saved. In the United States several statutes prevent regulators from considering the benefits and costs of certain life saving regulatory actions. As a way around this political problem, a technique called risk-risk or health-health analysis has been proposed. This analysis changes the calculated trade-off from dollars for lives to lives for lives. This analysis can be done because there is an opportunity cost in terms of risks not reduced when resources are spent in complying with regulations. When an economy’s per capita income increases, part of the increase is spent on risk reducing activities. Moreover higher income also seems to cause people to act more safely. The well known finding that countries and people who have higher incomes tend to live longer supports this proposition. Estimates done for the United States of this effect find that a loss of US\$12 million to US\$15 million in income results in one life lost. Thus if a regulation costs more than US\$12 to US\$15 million per life saved, it is actually saving fewer lives than the baseline case of not regulating. Since the first law of regulators, as it is for medical doctors, should be: “First do no harm,” it is hard to argue against the moral basis for this type of analysis. Note however that since the WTP estimate used in BCA for the United States has been found to be about US\$5 million per life, fewer regulations would pass a BCA test than a risk-risk test. Before this approach is likely to find widespread acceptance, however, the empirical bases for the numerical estimates have to be refined. In any case since BCA represents the economically superior method because it includes all opportunity costs in its calculations, it should be used where permitted<sup>32</sup>.

It has been said about the problem of building public institutions to manage a market economy for an economy in transition that “it is easier to build a house on vacant land than to have to tear down an old house first.” The CEECs have an opportunity to adopt institutions and techniques that most OECD countries have taken years to develop and whose development often challenged special interests who had large stakes in their existing regulatory systems. Although the CEECs have their own set of unique regulatory issues not faced by most countries, such as a lack of needed economic regulations and institutions and a need to develop them quickly in order to align their regulations and legislation to prepare for possible integration into the internal market of the EU, the lessons learned and the experiences of the OECD countries should provide useful models from which the CEECs can craft their own systems.

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32. For a discussion of the theoretical and empirical basis for this approach and its use in the US see Randall Lutter and John F. Morrall III, “Health-Health Analysis: A New Way to Evaluate Health and Safety Regulation”, *Journal of Risk and Uncertainty*, 8, 1993.

**PUBLIC POLICY ASSESSMENT IN FRANCE**  
**BY FRANÇOIS STASSE<sup>33</sup>**

**1. Introduction**

***The Burden of History***

Approaches to evaluation in France vary widely. The first requirement for any analysis of public policy evaluation is to very carefully define the underlying concepts.

As we shall see, public policy evaluation is the fourth stage in a process which is rooted in the past to a considerable extent. The reasons why France came so late to policy evaluation, and why the procedure was a relative failure, can only be understood in the light of the historical importance of a centralised state.

***The Influence of the Distant Past***

In France, unlike in the United States or Germany for example, the state came into existence well before the nation. The legitimacy of state intervention appeared several centuries before society challenged the state's power. As early as the 17<sup>th</sup> century, the central authority had created a *finance administration* and a *ministry of public works* endowed with considerable resources and prerogatives. Napoleon in the 19<sup>th</sup> century and the Republic in the 20<sup>th</sup> century strengthened this trend.

As a consequence, the question of the public interest has been highly politicised. The public interest is not the outcome of a grass-roots consensus between the various constituents of civil society, as is the case in Germany for example, but rather the expression of a political majority of which the government is the executive arm.

This marked feature of the Jacobin mindset makes any evaluation of government action difficult, since it comes up against a problem of political legitimacy. It is hard to see how experts can question political choices which, in theory, express the will of the people.

The political difficulty is compounded by a sociological one. As the state very soon came to have a predominant position in the French economy, a substantial proportion of the elite identified with it and sought to work for it. This was the origin of the elite bodies in the service of the state whose purpose is to

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provide high-quality administrative and technical leadership. Government projects are thus conceived and executed by technicians trained in the best institutions whose reputation is such that for quite some time it seemed incongruous to assess their work, or in other words, to suggest that they might not have chosen the best solution.

Certain public sector successes, such as nuclear policy and railway policy, owe a great deal to this superiority complex on the part of the state's senior technical and administrative managers. On the other hand, so do its failures, such as information technology policy.

### ***The Influence of the More Recent Past***

The modernisation of the state just after the Second World War was carried out on the basis of this centrist model. The new armoury of the modern state, and three elements in particular, served only to strengthen the existing tendency:

1. New state-owned enterprises were created by nationalising in core industries, and in the transport and energy sectors.
2. National accounts were created as a tool for measuring and forecasting economic activity.
3. The welfare state grew, in particular, by creating a vast social security apparatus.

Pre-war Keynesian economics, applied only after the war, strengthened the idea that the state, by using these new instruments, could effectively influence economic and social development.

These historical factors explain why four different conceptions of assessment corresponding to four different levels of state intervention have been implemented:

1. national economic assessment;
2. budgetary assessment;
3. assessment of state-owned enterprises;
4. public policy evaluation.

## **2. National Economic Assessment**

National economic assessment is carried out at a macroeconomic level.

### ***2.1. An Equilibrium Account***

This form of assessment was developed in the 1950s following the invention of national accounts. The system of national accounts establishes an equilibrium account between the inputs and outputs of each of the main categories of economic agents (households, companies and administrations). It then adds up all these aggregates in order to obtain the fundamental economic equation:

$$\text{GDP} + \text{M} = \text{C} + \text{S} + \text{X} + \text{inventories}$$

where

GDP = gross domestic product

M = imports

C = consumption

S = savings

X = exports

inventories = inventory variation

## **2.2. *From Bookkeeping to Forecasting***

Until the 1960s, this macroeconomic assessment was mainly of an accounting nature. Since the 1970s, advances in econometrics have made it possible to develop dynamic forecasting models.

These mathematical models, consisting of hundreds of computer-run equations, produce short-term forecasts of economic activity. The models fall into two categories: national and sectoral.

*National models* take data from the national accounts and introduce interrelationships between the different variables. Some of these variables are exogenous, meaning that they are determined in an arbitrary fashion by experts and incorporated into the model. This is the case in particular for data relating to the international environment and the government's broad budget stance. Likewise, the main determinants of monetary and financial factors (interest and exchange rates) are generally exogenous. The other variables are endogenous, meaning that they interact according to logical connections within the model, devised with reference to empirical observation and prior principles of economic theory.

Each year, in the spring and the fall, the French government carries out two macroeconomic forecasts of this type. Initially, these forecasts took account only of the physical variables of the economy such as the quantity of available work, wage rates and investment levels. Since the mid-1970s they have also included financial variables, notably interest and exchange rates. At a time when financial movements have become globalised, it would clearly be inconceivable not to take account of the interaction between monetary and financial variables and real economic variables.

*Sectoral models* work in the same way but apply to a limited economic sector only. The agricultural model, for example, called MAGALI, seeks to determine the effects on the agricultural sector of one or more changes to its environment. The model regards the entire agricultural sector as a single economic agent which makes production choices according to projected profitability.

The model includes exogenous variables, in particular the quantitative limits set by the French government and the EU on farmland under cultivation, production ceilings and recommended prices. On this basis, the model applies two sets of endogenous equations. The first links prices to agricultural production choices and incomes; the second describes the interactions between investment and income and incorporates variables relating to the financial conditions of investment.

## **2.3. *From Forecasting to Assessment***

National macroeconomic forecasts include all the variables of the economy. However, the quality of results observed over some twenty years has been rather mediocre. The essential forecast concerning GDP

growth, for example, has displayed a variation of more than one point between the forecast figure in the autumn of year n-1 and the actual figure for year n.

It should be emphasised that this variation is an average which eliminates the most extreme variations. When the economy is in step with the existing trend, variations are small (around half a point); at a cyclical upturn or downturn, on the other hand, the forecasts can turn out to be very wide of the mark. Between 1973-1975 and 1990-1993, for example, the aggregate variation rose to 7 points. This means not only that the economists had failed not only to predict, the oil shock in the first case, and in the second case German reunification (which it would be unfair to hold against them since such events fall well outside their brief), but that they were also unable to adapt their forecasts after these major changes had taken place.

This object lesson in modesty makes it easier to understand why assessment gives more reliable results than forecasting. Assessment is defined as the estimation of the macroeconomic consequences of changes to a *single* variable or small number of variables. For example, macroeconomic models may be used to measure the impact of a change in interest rates. The model's equations will calculate the effects of such a change on the cost of public debt and on the distribution of household income between savings and consumption. The result will be a more precise calculation of the effect on final demand, which in turn affects the level of activity and employment.

The quality of such an assessment is due to the fact that it takes place at the margin. In other words, the effects of changes to a *single* variable are calculated without modifying any of the other variables. The risk of error is correspondingly reduced. The principal remaining risk is the general assumption that economic agents behave rationally. Faced with a change, they are assumed to behave as they have in the past and as economic theory defines the maximisation of individual interest. However, especially in times of uncertainty or crisis, individuals may not behave rationally.

#### **2.4. The Players**

The players involved in macroeconomic assessment are clearly defined. Most are part of the apparatus of government. Statistical information is collected by the *Institut national de la statistique et des études économiques* (National Institute of Statistics and Economic Studies, INSEE), an independent public body attached to the Ministry for Economic Affairs and Finance. INSEE is also responsible for drawing up the national accounts for *past years*.

Macroeconomic forecasts and assessments are carried out by the Forecasting Directorate, which is a unit of the Ministry for Economic Affairs and Finance responsible for future economic accounts. These two administrative bodies have large staffs and substantial resources and work almost exclusively for the government. They represent the bulk of France's capacity for macroeconomic forecasting and assessment. However, other bodies with more modest resources also produce high-quality work, such as the forecasting and assessment units belonging to:

1. Paris University;
2. the main employers' unions;
3. the major banks;
4. the Chamber of Commerce and Industry, an umbrella organisation for small and medium-sized businesses in the manufacturing and distribution sectors;

5. a publishing group specialising in economic publications.

These independent bodies are useful for two reasons:

1. greater diversity of comment and analysis;
2. experience shows that *average* results of the forecasts and assessments carried out by both private and public bodies is closer to observed reality than the results of those carried out solely by the government. Spreading the net wider thus helps to improve the quality of results.

This observation argues in favour of the creation of a “council of sages” comprising representatives of each of these public and private bodies which, as in Germany, would meet regularly at the government’s behest in order to advise it on developments in the economy. However, the idea has not yet been put into practice in France.

### 3. Financial Assessment

Financial assessment gives the direct cost of a measure for the government budget. It is carried out year-round by the Budget Directorate, one of the main units of the Ministry for Economic Affairs and Finance, and by each ministry’s financial directorates. The sum of all these measures constitutes the government budget. The total amount of the budget thus depends on the choice of measures made each year by the government, and also on developments in the economy as a whole. An important link exists therefore between macroeconomic assessment and financial assessment.

#### 3.1. Expenditure

The **first stage** in preparing the budget for the next year (n+1) consists in calculating how previous appropriations will change according to variables in the economic situation. The starting point for this calculation, which takes place in the spring of year n, has to be the *last known budget*, or year n-1. On this basis, the first calculation is of *expenditure under current legislation* for year n, i.e. the amount of expenditure in year n equal to the strict renewal of expenditure in year n-1, excluding all new measures.

The legal definition of expenditure under current legislation “represents the minimum appropriation that the government deems indispensable in order to provide public services under the conditions approved by Parliament in the previous year”.

Three main variables need to be taken into account in order to calculate this expenditure:

- the rise in prices in year n, which affects the cost of all goods and services consumed by the government;
- changes in interest rates, which affect the cost of debt;
- the automatic revaluation of the wages of state employees, which affects the government's operating costs. This is not a wage increase decided by the government, which would be a new measure, but the automatic change in the size of the wage bill, without any government decision, caused by annual increases in staff seniority and qualifications. Known by its acronym GVT (*glissement vieillesse technique* — technical seniority shift), this factor is far from negligible:

each year it represents around 1 per cent of the government payroll, or over FF 4 billion for a total wage bill of over FF 400 billion.

Once expenditure under current legislation has been calculated, the **second stage** involves taking account of *new measures* in year n, i.e. decisions already taken by the government in the spring of year n and those which it is assumed will be taken later on in year n.

These new measures are divided into two parts, according to their financial effect in year n and in year n+1. The effect in year n+1 is called the *overhang* and is particularly important when calculating the cost of public service wages. Let us take the example of a (male) government employee recruited on September 1 of year n. His wages in year n will represent only 4/12 of his annual salary since he will have worked only 4 months. If the budget for year n+1 is calculated solely on the basis of renewing the budget for year n, 8/12 of the employee's salary will have been left out of the calculation because the employee will work 12 months in year n+1. Clearly, the greater the staff turnover in year n, the larger the overhang.

The **third stage** in preparing the budget for year n+1 involves calculating the effect of macroeconomic forecasts. This is where the link between economic assessment and financial assessment comes to bear. The link concerns not only the calculation of expenditure, which is affected by changes in prices and interest rates, but also the calculation of revenue, which is affected by prices and interest rates as well as by the forecast real growth of economic activity, since revenue from the principal taxes, especially the consumption tax (VAT) and income tax, is directly related to growth.

The **fourth stage** in preparing the budget for year n+1 involves adding the amount of *new measures* planned by the government for year n+1 to the previous calculations.

These new measures are negotiated bilaterally between the Budget Directorate and the other ministries. Their cost is added to the budget for year n+1 as it stands on completion of the previous three stages. No account is taken of the possible macroeconomic effects of these new measures or of any change they may cause in the behaviour of consumers or savers.

These various calculations are carried out within a nomenclature of expenditure divided into 7 principal items (See Annex 1) and are treated differently depending on whether they concern operating expenditure (See Annex 2) or capital spending (See Annex 3).

### 3.2. *Revenue*

There are very considerable differences between the assessment of revenue and the assessment of expenditure. As far as procedure is concerned, the main difference is due to the fact that, unlike expenditure, revenue is not negotiated by the Ministry for Economic Affairs and Finance and the other ministries. The Ministry for Economic Affairs and Finance alone decides on the assessment of revenue.

The political situation is reversed. In France, the balance of power between the government and parliament gives the government a quasi-monopoly on expenditure decisions. Parliament, on the other hand, has greater powers to vote taxes. Revenue assessments must therefore take account year by year of parliament's attitude towards the various sources of tax revenue.

Economically, macroeconomic variables play the most important role. Forecasts of real growth and inflation are particularly sensitive because they considerably influence most taxes. They are not the only ones that count, however, which makes assessment all the more difficult. Let us take two examples:

1. VAT revenue (44 per cent of total revenue) obviously depends on the rate of real growth and price rises. As a tax on consumption, however, it also depends on changes in the distribution of household income between consumption and savings. This distribution itself depends on changes in interest rates, which determine the yield from savings, and psychological factors which cause individuals to save more or less depending on whether they think the future is going to be more difficult or whether they are looking forward to an increase in their purchasing power.
2. Revenue from oil taxes (almost 10 per cent of the total) also depends of course on how the economy fares: consumption of oil products rises and falls in line with economic growth. Other factors also come into play, however, such as changes in the dollar exchange rate, because oil imports are paid for in dollars, or the breakdown between different energy sources (oil, coal, nuclear, etc.). Although the latter factor can be predicted fairly accurately, past experience has shown that the dollar exchange rate is prone to fluctuations that are difficult to anticipate.

### 3.3. *Procedure*

The budget procedure mainly involves setting expenditure since, as we have said, it is the only element subject to negotiation.

The distinctive feature of these negotiations is that they are *bilateral*, conducted between the Ministry for Economic Affairs and Finance and the other ministries. They mainly concern the overall growth and allocation of appropriations (see the example of the research budget in Annex 4) and new measures. Any points of disagreement that remain on completion of the procedure are put to the Prime Minister for a final decision.

The essentially bilateral nature of the procedure is open to criticism. It is by no means inconceivable that the budget procedure should *begin*, rather than finish, with a joint review of the main wishes of *all* the ministries for the year to come and that the government should decide its priorities at that point. This would perhaps make it easier for each ministry to refine its budgets while giving public opinion a clearer picture of government priorities.

Ideally, the budget procedure takes place in two stages. The first part of the discussion is devoted to an analysis of the “technical adjustment budget”, meaning an exhaustive survey of the international, statutory, regulatory and contractual commitments that constitute the government’s only real obligations.

This method makes it possible, in the second stage, to identify clearly the leeway within each budget and, most importantly, to distinguish the things that can be changed in the short term from those that require an amendment of the rules on which changes in expenditure depend.

Financial negotiations are informed by material indicators of effectiveness or response to needs such as class sizes, the number of police officers per 1 000 inhabitants, the rate of public subsidy for social housing, the number of nurses per hospital bed, etc. Each of these indicators has its qualities and its shortcomings, but they all help to inform the decision; we should always bear in mind that the ultimate aim of the budget procedure is to make *choices*. Negative choices, or refusals, are bound to displease some of the population. It is therefore necessary to ensure that they are determined after a procedure covering all the main arguments has been completed.

It is also important that the budget procedure should provide for a *contingency reserve*. Political and economic life is full of unforeseen and unforeseeable events. Prudence dictates that, during year n, some of the budget (from 2-5 per cent) for year n+1 should be set aside for contingencies.

For the same reason, it is better not to immobilise the budget with excessively burdensome, multi-year commitments. It has been said, it is true, that medium to long-term programming of major national policy objectives is a matter of sound management. Other than in exceptional circumstances, however, such programming should provide guidance rather than impose imperatives. Otherwise, it becomes virtually impossible to manage short-term vicissitudes without increasing the budget deficit to damaging proportions.

### 3.4. Results

The care taken in drawing up the government budget does not guarantee that carrying out the budget will confirm the forecast. Judging from the budget deficit, performances can vary widely from year to year:

<b>Budget Deficit (in Billions of Francs)</b>	<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>
Forecast	- 90	- 81	- 90	- 165
Actual	- 93	- 132	- 236	- 330

These figures show clearly that the assessment is relatively accurate when the pace of economic development is steady (1990-1991) but that it deteriorates considerably during downturns (the 1992-1993 recession). A detailed examination of expenditure and revenue would show that the main factor behind the variation between forecasts and actual results is the effect of the economic situation on *revenue* forecasts. This should lead governments to be more cautious in this area, whereas they often tend to focus their attention on spending.

## 4. A Microeconomic Assessment of Public Investment

Public investment represents a substantial area of public policy. The government is sometimes the only investor capable of assuming the cost of certain capital projects. This is the case, for example, when the financial scale of investments is too great or when their short-term profitability is insufficient for private enterprise to support them.

Economists have developed models for assessing such investments. They are microeconomic models insofar as they are concerned solely with the direct effects of the investment on its specific sector. They offer no possibility for assessing, for example, the effect of a sectoral investment on national employment levels, savings or consumption. Investment in transport infrastructure provides an example that lets us describe the principle behind assessment models and show why, ultimately, they are of little practical use.

#### **4.1.     *The Example of Public Transport***

This example has not been chosen at random: the transport sector has accounted for approximately 50 per cent of government investment over the last twenty years, and is therefore extremely important.

Economic models have been developed which distinguish two classes of variables:

a)        *Direct* variables, including in particular the cost of infrastructure and capital goods, operating costs, financial costs arising from the amortisation of capital goods and debt, a function linking pricing, competition from other means of transport, and utilisation rates. These various elements make it possible to calculate a break-even point for the investment and how long it takes to reach this point.

The importance of this profitability lag should be emphasised, since it plays an essential part in the final cost of the investment. The project is almost always too vast to be financed entirely from cash flow, so that debt represents an often substantial proportion of the financing. The cost of this debt is added to the cost of the initial financing until the entire amount has been reimbursed from revenue produced from the use of the facility. Whether the revenue derives from a public tariff paid by users (if there is a utilisation charge) or from taxes (if there is no charge) has no effect on the nature of the calculation: the investment's *real* cost is its *discounted* cost, meaning the initial cost plus the interest cost or the value of forgone consumption.

b)        *Indirect* variables, including in particular an environmental impact assessment, an assessment of the financial impact of the time saved by travellers and a reduction of congestion created because there was no previous means of transport, an estimate of the extra demand induced by the convenience and comfort of the new means of transport.

These indirect components lead economists to shadow, or fictive prices for a certain number of advantages or disadvantages with no direct market value.

Adding the elements in a) and b) above produces an overall financial assessment that theoretically lets the decision-maker make a choice on the basis of a comprehensive picture of the consequences of the investment.

#### **4.2.     *The Limitations of Complex Assessment Models***

Experience shows that public decision makers make little use of models incorporating indirect variables. The difficulty probably lies in translating dissimilar variables into monetary terms. Of course, economists have good reasons for trying to put a price tag on the impacts on the environment, on pollution, and on urban congestion, etc., but for most citizens, and hence for their political masters, any assessment of these factors is primarily political.

This point is borne out by two recent examples. The first concerns both the transport and the agricultural sectors. Government engineers have long considered developing France's biggest river, the Loire, both to make it navigable over a longer distance and to make better use of the neighbouring farmlands. Developing the Loire would involve building several major dams and transforming certain pristine sections along it. Studies showed that such a development would be economically advantageous.

Ultimately, the government shelved the project for political reasons. Many ecological pressure groups conducted an energetic media campaign to convince public opinion that development would cause considerable prejudice to the countryside through which the river ran. The countryside is part of France's cultural and geographical heritage, and this argument proved stronger than the economic interests of the project.

The second example concerns the railways. French railways are run by a state-owned monopoly, the *Société Nationale des Chemins de Fer* (SNCF). Since developing its high speed train (TGV), the SNCF has sought to provide this new service to several destinations, with Paris as the starting point of the itinerary. The capital cost is extremely high, however. Their high speed means that these trains cannot run on ordinary lines and special new lines have to be built. The SNCF planned to build new lines towards destinations where the discounted cost of the investment would be the lowest, i.e. where the investment would be recouped soonest because of a high utilisation rate. This criterion led the SNCF to invest first in lines towards the South-East (Lyons and Marseilles), the South-West (Bordeaux and Toulouse) and the North (Lille, Brussels and Amsterdam). There was no question of building an eastern line towards Strasbourg and Germany in the near future since by all estimates, the investment would take many years to recoup.

Fully aware that the economic assessment of the project did not justify its choice, the government nonetheless decided to build the eastern line. Three political factors tipped the balance:

1. Strasbourg's European role. The European Parliament headquarters are in Strasbourg, and the city is in competition with Brussels to become the political capital of Europe. The government felt that it was essential for Strasbourg to be served by a modern rail network in order to strengthen its credibility as a political capital.
2. The relations between France and Germany. The TGV lines to the South-East, South-West and North draw France nearer to its neighbours in Italy, Spain, Belgium and the Netherlands. It was difficult to imagine that France would not have a fast rail link with Germany, its main political ally and trading partner.
3. Pressure from the eastern regions. Lorraine and Alsace have suffered enormously from the collapse of the steel and textiles industries in the 1980s and 90s. They argued that without a fast link bringing them closer to Paris and the rest of the country, they would feel the economic pull of Germany even more strongly. In order to make their argument more convincing, they offered to make a major contribution to the cost of building the new line.

These two examples show the limitations of a purely economic rationale. Nonetheless, the economic assessment of public investment remains important and even essential, especially for measuring the direct variables described above. Indeed, there must be very strong reasons for not following the conclusions of economic assessments, because the consequences would impose a deficit burden to the community over a longer period. It is important to realise that political reasons do exist on occasion.

## **5. Public Policy Evaluation**

A first wave of public policy evaluation occurred in France in the 1970s, drawing on the American experience of PPB (planning, programming, budgeting), a system which grew out of an initiative to optimise US military choices at a time when the military budget was ballooning as a result of the cold war and the conflict in Vietnam. PPB was brought into France as budget choice rationalisation, or RCB.

### 5.1. *The French Experience of PPB/RCB*

*Rationalisation des choix budgétaires* (RCB) is generally taken to refer to two budget methods introduced into France in the 1970s, though in fact the two have little in common.

#### a) *Defining Tasks and Assigning Temporal Priorities*

The first form of RCB, derived directly from PPB, consisted of a three-stage methodological process of definition and classification.

##### *Planning*

Planning involves the consideration of long-term strategic options intended to define the government's tasks in each of its main areas of intervention. Once these tasks have been defined, a number of broad objectives are set and indicators are developed, making it possible to assess the extent to which they can be achieved.

The most important aspect of this phase is to identify society's problems clearly so that government action can be based on specific necessities and not merely on an instinct to preserve the structures of state.

Objectives formulated at the planning phase might include such things as increasing the number of young people entering university or reducing the number of people suffering from heart disease. These two examples concern important social issues that can be resolved only by long-term action. They also involve a large number of complex variables and are thus well-suited to the PPB approach.

##### *Programming*

Programming consists in making the objectives formulated in the planning phase operationally achievable in stages over time. The purpose of programming is therefore to determine by what *means* the planned objectives can be achieved and the *schedule* according to which budget should be committed in order to achieve the objectives within a given *time*.

Taking the two examples given above, programming should include:

- For educating young people: a school building programme, a teacher recruitment programme, a programme of educational reform to ensure that teaching methods are suitable for greater numbers of pupils, and a programme of grants to help poorer families finance their children's education.
- For reducing the incidence of heart disease: a programme for training doctors in cardi-vascular issues, an anti-smoking programme, a health education programme focusing on diet, and a programme to equip hospitals so as to provide more effective patient care.
- The main aim of programming is to define initiatives precisely and schedule them appropriately so as to avoid waste. For example, there is no point providing hospitals with highly sophisticated equipment if there are not enough trained staff to operate it. This example is not chosen at random: such blunders occur relatively frequently, even though they could be avoided by rigorous application of PPB methods.

## *Budgeting*

This is the classical phase where there are the fewest differences of approach. It involves calculating total programme costs, which generally extend over several years, and estimating the amount required to fund them each year.

Budgeting is not always easy because it has to accommodate the constraints of annual budgets. In France, as in many other countries, parliament votes the government budget year by year and it is not possible to commit public funds for more than one year. This rule is understandable, even though it has the disadvantage of limiting the time frame of government action, because the authorities need to be free to adapt to changes in the national and international economic situation.

The constraint of annual budgets means, therefore, that a programme scheduled to last 3 years may be shelved after the first or second year if the government budget suddenly has to be cut. In order to avoid absurd situations (such as a construction project halted when the building is a mere shell, or civil servants recruited to manage a benefit programme that has not been funded), an attempt must be made, as part of the budgeting process, to divide programmes up into homogeneous annual phases. In other words, programmes should be cut up into separate sequences which can function effectively *even if the remainder of the programme is shelved* for economic reasons. The point is important as the situation comes up often.

The Defence Ministry provided an interesting example of the PPB approach in the mid-1970s<sup>34</sup>. It defined nine major programmes, the first five of which corresponded to the main tasks of the armed forces and the other four related to logistical support:

1. Strategic nuclear forces to act as a nuclear deterrent (or response);
2. Tactical forces (French First Army), whose task is to resist a conventional attack from outside;
3. Security forces (operational territorial defence or surface defence), whose task is to resist internal subversion or a parachute attack;
4. External action forces (overseas intervention force);
5. General purpose forces, which include a number of units such as air bases which cannot be allocated to one of the first four programmes because they may be used for one purpose or another according to circumstances;
6. Weapons research, development and testing (naval, air, land and nuclear);
7. Personnel support, covering recruitment, training and personnel management;
8. Equipment support;
9. Central administration and the general staffs.

These main programmes are divided into 34 sub-programmes and 450 items. For example, the tactical forces programme (programme 2) includes a sub-programme 21 “Land forces”, a sub-programme 22 “Air forces”, a sub-programme 23 “Naval forces” and a sub-programme 24 “Common services and research”. Programme items are actual operational units: an armoured brigade, a fighter squadron, a frigate fleet, an air base, etc. Each programme item is allocated to a single main programme. The structure appropriately highlights the forces’ objectives (“tasks”), but it bears little relation to conventional budget nomenclature

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34. Cited by R. de la Genière. *Le Budget*, Presses de la FNSP, Paris, 1976.

and the organisation of the armed forces. In order to make the structure financially and administratively operational, it should have been possible to blend the two approaches; however, this was never achieved satisfactorily and the initiative failed to produce all the expected results.

Nevertheless, the experience of PPB has been fairly encouraging. Even though this approach is no longer used, its intellectual underpinning has become part of the texture of government. Of course, many measures are decided for immediate political or economic reasons untouched by the PPB spirit is not applied. However, it is now acknowledged that, as far as possible, government budget priorities should be decided along lines similar to those recommended by PPB.

#### b) *Multi-Criteria Analysis*

The second method associated with RCB was multi-criteria analysis. This approach concerns the technique for *choosing among projects*, and has little in common with the first. The technique consists in placing the various criteria for choosing a programme on the same scale of measurement. For example, the best-known RCB study involved drawing up a programme for improving road safety. Three criteria were set:

1. saving x thousand lives;
2. not reducing traffic speeds below y kph;
3. not exceeding a budget cost z.

Each measure was classed according to these criteria. For example, improving and upgrading cross-roads is very expensive (low score) but saves a large number of lives (high score). Installing road signs does not cost very much, but nor does it save many lives. Speed limits are inexpensive but inconvenient to road users. Each measure was assigned a score according to the criteria.

If the same measure comes top for all criteria, it should clearly be chosen. If the same measure always comes bottom, it should equally clearly be rejected. The problem becomes more complicated when measures score well according to one criterion, less well according to another and poorly according to a third. When the measures are compared two by two, the criteria determining when one is better than the other can be isolated. One measure is better than another if it scores higher for the majority of the criteria (equivalence rating between 0.5 and 1). For example, if it is better for six out of ten criteria there is an equivalence rating of 0.6. A table of equivalences for each pair of measures can therefore be made. If a particular measure must have a very high bilateral equivalence ratings in order to be chosen, it is quite possible that no such measure will be found. In that case, a lower equivalence rating will have to be accepted, making it possible to identify a group of measures that are (slightly) better than the others. A choice will still remain to be made from this group, using conventional methods: the purely rational approach has merely informed the decision. Multi-criteria methods do not offer the certainty of identifying the group of solutions that are better than others in the light of a certain number of criteria. For that reason, increasing the number of criteria may extend the social canvas spanned by the method, but too many criteria will undermine the effectiveness of the decision, or even the ability to take it.

The intellectual elegance of the system attracted public decision takers when the method was developed in the 1970s, but it was abandoned because of the need to classify very different sorts of criteria on the same scale. This does not mean that nothing of the experiment remains. What has disappeared is the goal of rationalising choices by basing all the determining factors on a single scoring scale. What remains is the habit of informing decision takers of all the aspects and consequences of a project and not merely, as had been the case previously, of its direct impact and financial cost.

Those taking decisions remain entirely responsible for them, but their responsibility is rooted more firmly in a political evaluation of the various criteria rather than in an illusory technical measurement.

## 5.2. *The New Approach to Evaluation in the 1990s*

The disappointing results of RCB limited action in this area over the subsequent decade. Only a handful of *sectoral* initiatives were completed, including in particular the creation of two specific evaluation authorities:

1. the national evaluation committee for public institutions of higher education;
2. the parliamentary evaluation office for technological and scientific choices. This body, which has an annual budget of FF 3 million and carries out exclusively technical studies, as for example on the safety of nuclear installations or the use of bio-fuels. Its work is of high quality but restricted to a limited field. It does not conduct economic assessments in the broad sense of the term.

The late 1980s saw a surge of renewed interest in the subject, stimulated by the lack of government action at a time when management evaluation procedures in the private sector were developing apace.

### *New thinking*

Three strands ran through the revival of public policy evaluation at the end of the 1980s:

1. **Democratic.** Evaluation was regarded as a way for citizens to monitor government action, thanks to clear objectives and transparent means for achieving them.
2. **Strategic.** Evaluation was regarded as a tool for simplifying choices. In an increasingly complex economic, social and technological environment, evaluation helps to establish a hierarchy among priorities so that funds can be earmarked for their realisation.
3. **Modernising.** Evaluation was considered a public management tool. The traditional view of public administration is that it provides public services such as ensuring security, educating the young, transporting travellers, caring for the sick, etc. The modernist conception of evaluation adds a dynamic element to this vision whereby the aim is no longer merely to accomplish a task or invest a particular area but to determine quantified objectives, define the means required to achieve them, mobilise teams in pursuit of them and assess the quality of the work carried out in the light of results. This view of things may appear commonplace to an employee in the private sector, but it is radically new to most people working in public administration.

### *New Institutions*

Following a report commissioned by the Prime Minister in 1988, a set of bodies and instruments were set up by decrees dated 22 January and 7 June 1990, representing the first attempt to institutionalise programme evaluation in France.

### Interministerial Evaluation Committee

Chaired by the Prime Minister, the committee includes the most important ministers. The secretariat is provided by the Commissariat au Plan, a government planning unit reporting to the Prime Minister.

The interministerial committee has a dual political function: to choose which evaluation projects will be funded, and to decide what action to take following an evaluation report.

### Scientific Evaluation Council

The Council, made up of eleven academics and government experts appointed by the French President on the basis of their professional abilities, has two tasks. First, it develops scientific evaluation methods and circulates them to everyone in the field so that their work meets recognised and homogeneous criteria. The Council's methods include the following:

- The authority commissioning an evaluation must draw up precise *specifications* with which the contractors for the project must comply.
- The body directing the study on behalf of the commissioning authority must be *independent*. This means, for example, that the body is not chaired by a government official.
- The advantage of ensuring that the body directing the study be *pluralist*. While it will naturally include representatives of the administrations concerned, it should also include, for example, outside experts, elected officials representing the populations concerned, researchers and academics.
- The work carried out must be *transparent*, meaning in particular that evaluation reports should be published.

Second, for each evaluation project, the Council verifies the quality of the methodology before the evaluation is carried out and the quality of the work done after the evaluation has been carried out. It should be emphasised that all evaluation projects *must* be approved by the Council before the work on begins. If approval is not forthcoming, the project cannot be launched. The Council has an annual budget of approximately FF 2 million.

### National Evaluation Development Fund

This fund is the main source of finance for evaluation projects. In 1994, the last year in which the evaluation policy functioned actively, its appropriation was FF 3.9 million, approximately half the total amount of project funding. The remainder came from the budgets of the ministries involved in the various projects.

The Economic and Social Council, a consultative body, also has discretionary use of 20 per cent of the national fund appropriation for projects of its choice, although like all other projects, they must be approved by the Scientific Evaluation Council.

### Projects Carried Out Since 1990

The evaluation revival in 1990 initially aroused real interest within ministries, though enthusiasm soon waned. Since 1990, over one hundred evaluation projects have been proposed and half of them were

rejected by the Commissariat au Plan before being submitted to the Scientific Evaluation Council because the subjects were not considered to be of sufficient interest. The Interministerial Committee considered twenty-four of the remaining fifty projects to be worthy of further study, but the Scientific Evaluation Council approved only sixteen of which two were abandoned by the ministries that had initially proposed them. During the five years of the new evaluation policy, only fourteen projects have been carried out:

- The rehabilitation of social housing;
- How public services receive less-favoured populations;
- Teenagers in difficulty;
- The government's social and cultural initiatives on behalf of its employees;
- Job-finding structures;
- The 1994 five-year employment law;
- Vocational training;
- The pace of children's lives;
- Government IT;
- Controlling energy;
- The treatment of wet rural areas;
- Mountain policy;
- Major natural hazards;
- Road safety.

The first eight topics are predominantly economic or social in nature, two are industrial (9 and 10), two relate to regional planning and development (11 and 12) and two relate to safety (13 and 14).

Each of these studies cost between FF 1 million and FF 5 million and averaged FF 2 million. Although the cost is high *per se*, the savings can be much greater if the study leads to a pertinent reorganisation of the sector.

Annex 5 summarises evaluation project 1 on the rehabilitation of social housing.

### *Qualitative Conclusions*

Several conclusions may be drawn, most of which are negative:

1. Most of the evaluation projects put forward by ministries and approved by the authorities do not concern essential issues of government policy.
2. Evaluation reports raised little stir in the administrations concerned or in the press, despite the fact that they were published in accordance with the transparency objective.
3. The interest aroused by the revival of evaluation in 1990 has waned. By 1994, it was clear that initial enthusiasm for the policy had worn off.

There are many political and practical reasons for this semi-failure and these should serve as a lesson for the future.

### **5.3. *The Political Sources of Difficulties***

Evaluation inevitably raises the question of the relative position of experts and politicians who, if evaluation is to work, both need to understand that the purpose is not to make a decision but to inform a decision. Defence choices in France provide a telling example. In recent years, the Defence Ministry has been asked to take part in the evaluation process. However, it has consistently responded by suggesting marginal themes for study. As a result, the French President recently made important decisions about the restructuring of certain weapons industries and certain units of the conventional armed forces without implementing the prior evaluation procedures provided for in the 1990 legislation. Of course, the government's decisions had been carefully reviewed beforehand by the Defence Ministry's own specialists, but not according to the scientific, independent and pluralist procedures drawn up in 1990.

Many similar examples could be mentioned to demonstrate that when major political issues are at stake politicians are reluctant to split the process into independent scientific advice on the one hand and political decision-making on the other.

There is doubtless no solution to this problem other than the Prime Minister's personal and forceful involvement in the choice of subjects for evaluation wherever they concern vital areas of government responsibility.

The transparency requirement, which appears natural in a democracy, is a formidable constraint in the eyes of the ministry concerned. Clearly, an administration might easily accept the scrutiny or even the public questioning by independent experts of some marginal aspect of its business. If the subject is an essential area of its mission, however, any public criticism can be seized upon by the government's opponents. Advocates of evaluation would thoroughly approve, arguing that the public airing of the major problems facing society is a mark of democratic progress. However, such progress calls for an admirable and rare virtue on the part of senior civil servants. For that reason it is worth raising the question whether, in certain cases, the evaluation might not be encouraged when it is confidential. Of course, there would then be a risk that the minister commissioning the report might simply sit on it and take no action. However, the risk of public evaluation getting bogged down in trivia is greater still.

The role of the Ministry for Economic Affairs and Finance provides one complex key to the problem. On the one hand, it is right that evaluation should show whether public funds are being committed to the most useful and effective ends. It is therefore natural to acknowledge the importance of the role played by the Ministry for Economic Affairs and Finance in the evaluation procedure. On the other hand, the presence of the budget watchdog has a perverse effect. Other ministries, fearing that the Ministry for Economic Affairs and Finance will take advantage of the evaluation procedure to dispute their funding levels, tend not to provide all the information necessary for a good study. This also explains why almost all the evaluation projects since 1990 have concerned marginal topics.

### **5.4. *The Technical Sources of Difficulties***

Evaluation may suffer from the conflict between scientific requirements and the imperatives for political efficiency which decision makers must consider. This conflict became clearly apparent between 1990 and 1996. The revival of evaluation in 1990 gave experts in the field greater authority, and they used it to

apply extremely strict procedural constraints to the initial projects (composition of expert groups, selection of people and places to be studied, statistical analysis methods, etc.). The purpose of these constraints was to ensure that the studies and their conclusions be scientifically beyond reproach. However, they also added considerably to the workload.

There were two main material consequences. Most reports were bulky documents of 300 pages and more from which political decision-makers found it difficult to glean any operational conclusions. Most projects took two years on average to complete. While this may not be unreasonable for an expert, is clearly too long for a politician from whom voters expect quick decisions.

As France is a relative newcomer to evaluation, there is little experience on which to base relations between specialists in the field and the government. One upshot has been a certain lack of understanding between the government and the experts. There is not enough emphasis on operational conclusions in the reports on the first projects. They are too analytical and not sufficiently strategic. This gap between expectations and results contributed to the feeling of disappointment.

### **5.5. Conclusion: Some Positive Aspects**

Despite the undeniable difficulties which have considerably curbed the development of evaluation, the overall results are not entirely negative. Politicians are much more aware of the need for public policy evaluation. New legislation now often includes a provision for assessing the measures enacted after a few years.

The authority of the specific evaluation institutions set up in 1990 may have been undermined over the years, but evaluation itself has made headway within the government and civil service. Two ministries (Education and Employment) have introduced evaluation units, and on 21 November 1995 the Prime Minister sent a circular to all ministers making an impact study compulsory before embarking on any important new legislative or regulatory initiatives. The circular sets out the information on which each impact study must provide systematic information:

- the expected advantages of the measure and its possible drawbacks;
- its impact on employment;
- its impact on the country's general interests and on the environment in particular
- its financial effects on the current budget and the budget for the next four years;
- its incidental effects on administrative formalities for business, users and administrations other than the one promoting the measure;
- its legal impact, including in particular a full list of other legislation to be repealed or amended as a result of the new measure coming onto the statutes.

The evaluation revival has begun to open up the government and civil service to the outside world. Ministers have begun to clarify the nature of their responsibilities and their objectives and to submit them to review by outside experts. The move towards more open government has certainly been one of the most positive aspects of the whole experiment, helping to bring government closer to the rest of society.

Likewise, parliament has begun to take an interest in evaluation. Of course, its actions in this area are not on anything like the same scale as those of the US Congress, whose General Accounting Office is extremely powerful. The American model goes against a long-standing constitutional tradition in France,

where the preponderance of the executive branch over the legislative branch limits parliament's power of control. Here too, however, things are changing: two laws were passed on 14 June 1996 giving parliament new albeit modest powers to assess government action powers that indicates that the idea of evaluation is making headway.

In the light of these conclusions, France may be said to have reached a halfway point. Evaluation was revived in 1990 but has not been as successful as had been hoped, for both political and technical reasons. If the approach is to be extended and improved, it would doubtless be necessary to copy the American model by creating a powerful evaluation office with substantial resources which would be responsible for centralising initiatives. This office is part of the legislative apparatus in the United States, but any such body would probably have to be part of the executive administrative apparatus in France.

**ANNEX 1. NOMENCLATURE OF GOVERNMENT BUDGET OUTLAYS**

<b>A. CIVIL BUDGETS</b>	<b>B. MILITARY BUDGETS</b>
<p><b><i>Category I: Public Debt</i></b>  <b><i>Category II: Public Authorities</i></b>  <b><i>Category III: Departmental Resources</i></b></p> <p>Part 1 — Staff, wages            Part 2 — Pensions and allowances            Part 3 — Employers contributions            Part 4 — Capital and operating expenditure            Part 5 — Maintenance            Part 6 — Operating subsidies            Part 7 — Miscellaneous expenditure</p> <p><b><i>Category IV: Government Action</i></b></p> <p>Part 1 — Political and administrative action            Part 2 — International initiatives            Part 3 — Educational initiatives            Part 4 — Economic initiatives            Part 5 — National interest enterprises            Part 6 — Social initiatives            Part 7 — Social welfare</p> <p><b><i>Category V: Government Investment</i></b></p> <p>Part 1 — Agriculture            Part 2 — Energy and mining            Part 3 — Transport and telecommunications            Part 4 — Industrial and commercial enterprises            Part 5 — Housing and town planning            Part 6 — Cultural and social public facilities            Part 7 — Administrative and other public facilities            Part 8 — Investment outside metropolitan France</p> <p><b><i>Category VI: Government Investment Subsidies</i></b></p> <p>Part 1 — Agriculture            Part 2 — Energy and mining            Part 3 — Transport and telecommunications            Part 4 — Industrial and commercial enterprises            Part 5 — Housing and town planning            Part 6 — Cultural and social public facilities            Part 7 — Administrative and other public facilities            Part 8 — Investment outside metropolitan France</p> <p><b><i>Category VII: Compensation for War Damage</i></b></p>	<p><b><i>Category III: Departmental Resources</i></b></p> <p>Part 1 — Staff, wages            Part 2 — Staff maintenance            Part 3 — Staff, employers contributions            Part 4 — Armed forces and departmental capital and operating expenditure            Part 5 — Maintenance            Part 6 — Operating subsidies            Part 7 — Miscellaneous expenditure</p> <p><b><i>Category V: Capital Expenditure</i></b></p> <p>Part 1 — Research, development and prototypes            Part 2 — Technical and industrial investment            Part 3 — Manufacturing            Part 4 — Infrastructure            Part 5 — NATO infrastructure</p>

## ANNEX 2. CALCULATING OPERATING EXPENDITURE

This calculation is carried out in two parts: staff expenditure and non-staff operating expenditure.

### Staff Expenditure

1. The previous year's *budget base* is carried over.
2. The base is *updated*, taking into account changes in civil service wage indexes and the full-year overhang effect of measures decided during the year.
3. The effects of *regrading* are calculated, i.e. the cost (positive or negative) of structural shifts in job patterns towards more or less highly skilled positions.
4. The cost of *new jobs* and savings from job reductions are calculated, applying an average cost per class and per grade (i.e. according to the type and level of the jobs concerned).
5. The cost of *new measures* is calculated:
  - topping up certain appropriations;
  - excess costs generated by according temporary staff permanent status
  - training costs;
  - pension adjustments.
6. Checks are made to ensure that the total cost *does not exceed* the predetermined appropriations ceiling.

### Non-Staff Operating Expenditure

1. Total or partial carry-over of the previous year's appropriations.
2. Savings to be made.
3. Topping-up of certain appropriations.
4. New measures.
5. Checks to ensure that the total does not exceed the ceiling.

### ANNEX 3. CALCULATING CAPITAL EXPENDITURE

Capital expenditure, which by nature is going to be spread over a number of years, is always calculated in two parts: programme authorisations (AP) and payment appropriations (CP). The programme authorisation sets the upper limit on the appropriation that may be committed for a given investment. Payment appropriations are made to cover *annual* expenditure as the capital project is carried out.

The procedure is as follows.

#### **Programme Authorisations (AP)**

1. Review of appropriations for year n and of forecast commitments before 31 December.
2. Determination of the level for year n+1, which consists of the balance of APs opened in previous years, especially APs for year n and new APs for year n+1.
3. Checks to ensure that the sum of the balance of past and future APs does not exceed the ceiling.

#### **Payment Appropriations (CP)**

1. Review of CPs contained in the budget for year n.
2. Forecast of CPs that will be consumed before 31 December (capital spending often runs behind schedule, meaning that planned CPs are not in fact consumed).
3. Calculation of CPs already voted, resulting from AP tranches opened in previous years.
4. Case by case discussion of requested new measures, checking the AP/CP ratio (called the “cover rate”). Depending on whether the investment will be made over 18 months or 3 years, for example, the cover rate will vary between 70 per cent and 30 per cent. A rule of thumb is to plan for 40 per cent in CPs in the first year, 50 per cent in n+1 and 10 per cent thereafter.
5. Determination of overall CP appropriations (CPs already voted + new measures) for each budget item.

## ANNEX 4. SETTING A MINISTRY'S BUDGET FRAMEWORK

### The Research Budget

**Hypothesis:** To increase total research expenditure over a 5-year period to level  $x$  expressed as a percentage of GDP.

### Budget Procedure:

1. Calculate the increase in expenditure to be made by all those involved in research.  
Example: + FF 30 billion in 5 years.
2. Allocate the increase among the various players. Example:  
+15 for industrial companies (to be negotiated)  
+5 in tax breaks (to be defined)  
+10 in additional budget expenditure
3. Determine the annual budget effect by type of charge. Example:  
+1 in staff costs  
+0.5 in departmental operating expenditure  
+0.5 in capital expenditure
4. Consider, on the basis of various scenarios, several possible allocations of expenditure between the ministry and research bodies. Allocations must comply with predetermined block appropriations in the four main budget areas:
  - jobs;
  - operating expenditure;
  - payment appropriations relating to investors;
  - capital expenditure programme authorisations.
5. Check the overall change in appropriations after allocation.

## ANNEX 5. EVALUATION OF SOCIAL HOUSING REHABILITATION POLICY

Social housing rehabilitation policy was one of the 14 evaluation topics selected by the Interministerial Committee set up in 1990 (See Part IV of the note). The evaluation report was published by *La Documentation Française* in 1993.

It provides a good example of the type of subject treated, the method used and the interest and limitations of the conclusions produced by this kind of study.

The following is a summary and analysis of the main sections of the report:

1. The assignment given to the study's steering committee.
2. The method used.
3. The economic effects and results of rehabilitation projects.
4. A summary table of public expenditure in the field.

### 1. The Steering Committee's Assignment

In accordance with the wishes of the Scientific Evaluation Council and with the need for a pluralist evaluation, responsibility for conducting the study was given to a Steering Committee whose membership should reflect the diversity of viewpoints.

After familiarising itself with the interministerial apparatus for public policy evaluation, the Committee first reviewed changes in regulations and the results of existing studies, drawing on documents furnished by the Housing and Construction Directorate. The Committee's next task was to define the objectives and nature of the research and initiatives to be undertaken in the context of its assignment. It identified five major issues.

*a) The consideration given to tenants' expectations when programmes are drawn up.* What consideration is given to tenants when rehabilitation programmes are designed, planned and executed? To what extent do the steps taken and the work carried out correspond to the real concerns and priorities of the different generations and types of people who live in the buildings? Disparities between tenants' expectations and the concerns of the contracting authority need to be identified.

*b) The social impact of rehabilitation policy,* especially in terms of occupancy and segregation. As a consequence of financial effects (higher rents, greater or lesser ability to afford housing thanks to housing benefit, by type of household), rehabilitation has caused population shifts that differ depending on whether or not tenants receive housing benefit, thus emphasising segregation by housing, contrary to the objective that underlies rehabilitation policy of keeping sitting tenants. The aim is to find out whether rehabilitation causes a significantly greater displacement of households not reliant on housing benefit than the "traditional" pattern of mobility in the neighbourhood concerned. These segregative effects may have been exacerbated by the application of new housing benefit scales since 1988. When there is a squeeze on

rented housing, does state assistance go where it is most urgently needed? Do situation rents exist, caused by a perverse effect of the policy? Are housing benefit simulations, designed to highlight the impact of rehabilitation on the residual burden on tenants, sufficiently reliable? The evaluation should also study the links between rehabilitation policy and urban policy so as to measure the impact of their interaction more accurately.

c) ***The allocation of costs and financial advantages between the various parties.*** Rehabilitation involves a number of different players, with the government and tenants situated at either end of the chain and local authorities acting as referees. The aim here is to shed light on the system of cost transfers between the different players, on which the equilibrium of the operation depends. Are contracting authorities keeping investment costs and rental charges under control, especially where energy savings are concerned? Does the actual rent reflect the economic reality of the operations? What is the relationship between the end rent and the break-even rent? To what extent are rent increases resulting from rehabilitation really offset by planned reductions?

d) ***The links between rehabilitation policy and maintenance.*** Major maintenance and repair work may not be funded from the rehabilitation budget, since rent increases resulting from rehabilitation funding must be justified exclusively by improvements. Things are much less clear-cut in practice, however, and the common hypothesis that rehabilitation is used in order to catch up on maintenance should be confirmed or invalidated.

e) ***The architectural and urban impact of rehabilitation.*** Apart from structural and architectural transformations, what impact has rehabilitation had on the transformation of neighbourhoods and their image? Is there a positive link? If so, of what nature? Have neighbourhoods improved thanks to rehabilitation?

## **2. The Method**

The aim is to collect as much information as possible from the various participants in the selected rehabilitation projects to ensure the most accurate analysis possible. The study is based on 8 projects per site, giving a total of 80 projects carried out between 1982 and 1991.

In order to find the answers to five the questions put to the evaluation panel, the issues have to be situated in a broader framework which takes account of the background to the projects in various ways: the nature and assets of the authority commissioning the work, including its financial situation before the rehabilitation project; local housing policy and the local housing market; interactions between the players involved; procedures for carrying out the project; the objectives pursued and how they have been achieved.

### **a) Sources**

The difficulty of a retrospective survey comparing many projects on a number of themes lies in ensuring that the information collected is both complete and reliable while giving a relatively superficial analysis of each operation. The idea is to conduct an evaluation, not an audit.

The primary source is the contracting authority, which provides information on a good faith basis, meaning that the assessors carry out no controls or checks other than by comparing different opinions.

The approach is a pluralist one: so as to allow for comparative analysis of data, the same questions are put to a number of different parties.

The outcome of this approach may be threefold, inasmuch as it may:

- reduce the uncertainty that inevitably surrounds any information;
- complete information expressed from a partisan standpoint by one party;
- enable a comparison to be made between the views of two parties playing different roles in the rehabilitation procedure.

Because the contracting authority is so central, we sought to multiply our sources both within the authority, by canvassing a number of its representatives (director, technical officer, financial managers, social officers) and outside, by canvassing the local public facilities directorate, elected officials, tenants associations, social workers, contractors, etc.

#### ***b) From Conclusions to Conducting the Evaluation***

It is at this stage that the notion of choice appears. Hitherto, the method involved collecting information and rendering it comprehensible. Now the data have to be made meaningful, the most relevant results have to be highlighted, explanations have to be sought. Drawing conclusions mostly involves comparing data, finding the right connections, determining the typologies that may be of a discriminatory nature in relation to a particular phenomenon. In order to do this, it is often necessary to make cross-references between the major themes of the evaluation, to group data from various sources and interpret them in the light of the overall picture that emerges from this sea of partial information.

The results described in the following chapters derive from this analytical approach and need to be completed or interpreted in the light of contributions from the groups of local players set up in the framework of the participatory approach.

Because the project sample under review is so small and relatively random, figures have to be treated with care and in full awareness of any statistical conclusions that may be drawn under such conditions.

For this reason, the evaluation seeks mainly to highlight approaches and processes, influences and significant effects relating to rehabilitation policy and its implementation.

However, although 80 projects constitute a limited sample, the general questions about rehabilitation procedures were put to organisations that manage a total of some 700 000 housing units, making up a little over one fifth of the current social housing stock.

### **3. The Economic Effects and Results of Rehabilitation Projects**

#### ***a) Is Government Aid Economically Effective?***

Contracting authorities rarely think in terms of the economic effects and results of projects, since they generally keep investment and operations entirely separate. Social housing can clearly not be regarded as a real estate asset like any other, and it has to meet a number of specific constraints. There is thus no intention whatsoever to try and assess the “profitability” of an investment, especially as in this type of operation there is no investor as such. Initial funding is provided by the government, local authorities (which receive no direct financial advantage in return for their investment), the organisations that collect employers' compulsory housing fund contributions (which obtain additional reservations in return for their help) and the contracting authority, which supplements these funds with a minimum amount of its own money and receives revenue so that it breaks even on operations, rather than to remunerate the investment.

Nevertheless, the question of the economic effectiveness of the funds committed to social housing rehabilitation and their contribution to the financial health, good or bad, of the social bodies concerned must be posed. A further aim is to find out under what conditions government aid is most effective, which also means having the resources to compare the results of various operations.

**b) *An Analytical Model***

An analytical model has therefore been devised in order to reconstitute an economic appraisal of the 35 projects for which the necessary information was available.

The principle of the model is to homogenise all the parameters (e.g. inflation rate, discount rate, drift between expenditure and revenue) that do not depend on local situations or the contracting authority's particular characteristics and, in other cases, to preserve locally defined values (especially the end rent). The assumptions are the same as those used to calculate the "economic" break-even rent. The rate for supplementary provisions for major repairs is applied to the real amount of "pure" improvement work, from which the equivalent of maintenance work is subtracted. This rate is set at 1 per cent for all operations. Expenditure and revenue flows are analysed over a 20-year period, going well beyond the term of most loans. For each operation, they are shown as a curve corresponding to the aggregate balances of financial flows. Two composite indicators show the main features of these results: the payoff period, i.e. the point at which aggregate balances become consistently positive, and the current net worth (as for housing) of committed funds, an indicator of the financial operation's enhancement effect. Parameters that cannot be taken into account include the real level of maintenance spending, which may be related to dilapidation and vandalism caused by poorly controlled rehabilitation in difficult social environments, and the residual value of property, too closely linked to fluctuations in property values that are difficult to predict and the inclusion of which is in any case alien to the mindset of the providers of social funding.

Simulation results may be analysed according to the specific situation of each contracting authority, which may be described using three parameters: the cost of the work, the quality of funding (the major factor here being the possibility of obtaining preferential funding in addition to subsidised improvement grants for rented social housing) and the scope for raising rents (a theoretical value calculated as the difference between the ceiling rent and the previous rent). The economic result of rehabilitation projects depends to a considerable extent on these parameters, as well as on the actual level of rents set by the contracting authority. It is possible to establish a typology of operations according to these criteria and to analyse their impact on results.

The final outcome of operations can be shown by two indicators, depending on the preferred approach: for a "break-even rent" approach, the ratio between the actual rent and the break-even rent (which we assume to be equal to the "economic" rent calculated in the previous chapter); for an overall economic appraisal, the current net worth as a percentage of the investment amount (for a zero residual value).

There is one other indicator of interest, since it correlates fairly accurately with the overall economic result and offers a simple guideline for results. It is the ratio between the rent increase and the investment amount less subsidies. If the ratio is less than 8 per cent, the operation is generally "bad".

**TABLE 1. EXPENDITURE BREAKDOWN: AVERAGE FOR 41 OPERATIONS**

1 = 1 tranche of 5 KF.91. inc. VAT/housing (rounded up)		
All Ages		
	<b>Including All Cost Tranches</b>	
	<b>Expenditure Per Unit</b>	<b>% of Total Expenditure</b>
<i>For All Work:</i>		
Facade		14%
Roofing		2%
Insulation		32%
Heating		8%
Shared Facilities		10%
Technical Equipment		6%
Conveniences		23%
Design		3%
Surroundings		2%
<b>Total</b>	<b>90 KF / UNIT</b>	<b>100%</b>

*Maintenance:*

Facade		8%
Roofing		2%
Insulation		
Heating		
Shared Facilities		2%
Technical Equipment		2%
Conveniences		7%
Design		
Surroundings		
<b>Total</b>	<b>19 KF / UNIT</b>	<b>21%</b>

*Pure Improvement:*

Facade		5%
Roofing		
Insulation		15%
Heating		7%
Shared Facilities		7%
Technical Equipment		3%
Conveniences		7%
Design		3%
Surroundings		1%
<b>Total</b>	<b>43 KF / UNIT</b>	<b>48%</b>

**Comments:**

- Half of all expenditure concerns the building shell, of which two-thirds are spent on insulation.
- Only 10 per cent of the total was spent on shared facilities, despite the fact that the visual and psychological impact of such renovation is extremely important.
- Only 2 per cent of the total was spent on the surroundings, despite the fact that they help to define the general environment to the housing.
- Approximately a quarter of the total was spent on housing interiors.

## **ANNEX 6. EXPERIMENTING WITH A CONTRACTUAL APPROACH**

Better delegation of responsibility was one of the priority objectives identified by the Prime Minister in the circular of 26 July 1995 on the reform of government and public services. As part of this initiative, he asked for a contractual approach to be tried out.

Hitherto, relations between central administrations and line departments consisted in strict and detailed monitoring of resources and actions and entailed administrative management methods that are no longer suitable today.

No major company now operates in this way any longer, and the civil service has realised its handicap. The aim of the contractual approach is to reform administrative management methods in three ways.

### **1. Giving Managers Greater Responsibility for their Budget**

The aim of this reform is to give operational departments more leeway, both in the preparation of their annual budget and in the management of their resources during the year.

In the spring of each year, department heads will negotiate their total staff and operating budget for the following year with their central administration. Negotiations will be conducted at the same time as the finance bill is prepared, immediately after the budget framework has been set by the cabinet in April. It is up to central administrations to ensure that appropriations are compatible with the government's policy stance as reflected in the budget framework.

Each department will be given a benchmark block appropriation which is the sum of an overall operating grant and staff appropriations. Resources may be reallocated, either by cutting jobs in one category in exchange for jobs better suited to the department's tasks, or by proposing net staff savings and applying for increases when it seems appropriate. The only option to be denied is that of proposing net job creations over and above centrally-determined staff appropriations. This is clearly a very important point.

Because civil servants are guaranteed employment under French public law, the government must take staff recruitment seriously because they will then have to employ for the rest of their working lives. The contractual approach ensures that operating appropriations, which can be reassessed year by year, are not exchanged for permanent jobs.

Once the government has taken its decisions on the finance bill, departments will receive notification of their final budgets in terms of both operating grants and staff appropriations.

The department's resources must be managed during the year in compliance with the principle of specificity, since operating expenditure and staff expenditure are imputed to different items. Employment ceilings for the department must be respected. However, operating grants will be managed within a block appropriation that may include temporary jobs, provided that local financial comptrollers are able to verify that temporary employees are not filling permanent posts.

### **2. Improving Service Quality**

Service contracts will include precise objectives for services provided to users. Service quality will be assessed, in particular by means of user-satisfaction surveys.

### **3. Encouraging Greater Staff Involvement**

Department heads will consult unit heads, who in turn will consult employees on how resources should be allocated, both when the overall budget is being prepared and when resources are actually being allocated on the basis of the final budget.

Employees could be offered financial incentives linked to savings.

**KNOWING AND CONTROLLING JUST ENOUGH:  
ISSUES IN THE CENTRAL ASSESSMENT AND EVALUATION OF  
POLICY INITIATIVES AND CHOICE OF INSTRUMENTS  
BY FRANÇOIS LACASSE<sup>35</sup>**

**1. Overview**

This paper reviews the key issues related to the production and use of policy analysis in order to assist central institutions of government in managing their legislative, regulatory, and to a lesser degree, budgetary policy initiatives. The focus is on features of systems in OECD countries which have worked and failed, in the perspective of illustrating the issues which small public sectors — such as those in the Baltic countries — face when launching and insuring the growth of systems. By convention, when the term evaluation is used, we mean *ex post* evaluation of policies or programmes. When the issue is *ex ante* assessment of the impact of laws and regulations, we use the term Regulatory Impact Analysis, or RIA.

The issues developed in the paper have been classified in four categories: methods, organisation, use, danger zones.

The methods section deals with the present state of the art in economic and policy analysis. The focus is on its evolution, costs, potential uses, effectiveness and limits. This section is quite short given the contents of other papers prepared for this seminar; in particular, the paper by John F Morrall III deals extensively with RIA, a set of methods which are part of the core body of knowledge in policy analysis and which are the same as those used in *ex post* evaluation.

The *Organisation* and *Demand and Use* sections review the very considerable experience of OECD countries over the last 30 years in trying to systematically apply these methods to improve decision making, to increase quality and target efficiency of the policy objectives of legislation, regulations and direct expenditures. The experience of several countries with very different institutional set-ups and politico-administrative traditions nevertheless contains a series of constants, of successes and failures which allow for reasonably clear identification of the key issues to be faced when setting up or improving capabilities for systematic impact analysis, either RIA or *ex-post* evaluation.

The focus of these sections is on the challenges to be met to ensure that available methods and techniques are effectively used, that relevant analyses are effectively carried out and, even more important, are integrated into the decision-making processes to improve policy outcomes. Historically, most of the main obstacles to the production and even more to the effective use of impact analysis were quite poorly foreseen at the outset. Time after time, in country after country, the quality of the methods, their rigour and performance in other fields (for instance in macroeconomic policies, in military procurement, in academic and research centres work) led to serious illusions about their capability once they were transposed to a politico-administrative universe. In all cases they underestimated or altogether neglected the specificity of the both the political world and of the public bureaucracies that support it.

These sections on organisation and use draw from the experience of various countries and from analyses of the experience and in particular of the reasons why those particular ways of insuring the integration of

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35. Mr. Lacasse is an economist, professor at the Université du Québec (Hull) and a former official of the OECD and of the Canadian government.

policy analysis have been found effective or wanting. Enough time has gone by since the first brave attempts of previous decades, enough research and hard thinking has gone into explaining how and why the hopes of yesterday became the necessary reforms of today to generate some results which can be interpreted as genuine lessons and, as features applicable to all national contexts.

The fourth and last section, *Danger Zones*, takes off from one of the key issues identified in the organisation section: the filtering i.e. the selection of policy initiatives which should be submitted to the sometimes costly and time-consuming total impact analysis. Especially when setting up a system, this issue is one of the most vexing. For instance, without selectivity and with a great deal of formal requirements, delays and 'ritualisation' ensue which discredit the system or result in large scale by-passing or disregard of impact analysis.

*Danger zones* are those types and classes of policy decisions to which unexpected and unpleasant consequences have been attached often, in time and space, leading to significant political and economic costs. The list discussed in this section points out those areas where one can assume, almost right from the start that quite thorough analysis is necessary; cases where the potential pay-offs in risk and costs reduction (economic, budgetary, social and political) will almost certainly surpass the expense incurred by the analysis, but which we know, today, to be worth the delays involved.

## **2. Methods**

### **2.1. A Solid Core of Techniques**

Overall, there are few issues about the quality and relevance of impact assessment methods. Most of those that are readily available today enjoy a very broad consensus with respect to adequacy, reliability, limits, how and when they can be used.

This happy state of affairs exists in a broad area of policies . Consensual, well-tested techniques are readily available for virtually all investment projects, from infrastructures to natural resources or commercial type services, for calculating the benefits and costs, in determining a range of acceptable discount rates for estimating the value of time, the fictional or shadow prices for goods and services with prices that cannot be measured empirically (national parks), for foreign exchange, etc. Over the last decades, the refinements brought to benefit-costs analysis have made the instruments derived from it into a standardised set of tools with well-known strengths and weaknesses. Better still, inexpensive computing has substantially reduced the costs of sensitivity analyses and of simulations making it possible to track the effects on results of any given assumption with great precision.

For instance, measuring benefits from non-priced services like national parks or the absence of unemployment risks cannot be ignored today by arguing that such dimensions are unmeasurable, or cannot be calculated. They can be measured. Moreover the processes of economic assessment have allowed for great progress in making explicit the options, the values put on certain policy objectives (a secure petroleum supply, continuous public services, etc.). The same can be said about the capacity to precisely identify who gets what from whom in regulation, tax and budgetary allocations.

Over the last decades, methods for tackling quantitative analysis of legislation or regulation has improved moreso than those used for investment projects. Sectoral modelling (agriculture, transport, etc.), has followed macro-modelling into the realm of computable general equilibrium models. These were novel techniques 10 years ago, but since then, they have become “off the shelf” products which public

administrations can develop or purchase. Dynamic simulation models for social policies, while less advanced and less standardised, can nevertheless also be considered standard tools; the methodological issues (reliability, stability, high costs in money and time) are no longer problematic.

This rosy picture is overly simplified but is based on fact. Unfortunately, it tells only part of the story. There are still significant issues about use and organisation, described in the next section, but even most widely accepted and sophisticated techniques have their shortcomings whether in their methods, applicability or interpretation. The next sub-section deals with these.

## 2.2. *Limits and Blind Spots*

There are three types of technical limitations of readily available and consensual methods:

1) The unavailability or cost of data or technical information. The best known-example of this is the ongoing raging debate about global warming, desertification, toxicity of urban air pollution, etc. In all these cases, the scientific data and models from which the economic analysis can build impact assessments to handle the very complex interactions within large sets of interrelated phenomena are either unavailable or not very convincing. All things being equal, the same difficulties exist for the impact of social security on family preferences and for the social reintegration of prison inmates, etc.

On a more modest plane, the poor quality of data collected can imperil very sophisticated analyses in areas as diverse as industrial policies and R&D, crop forecasts, consumption patterns when wealth effects have to be taken into account, unemployment forecasts when movements in and out of the labour force were poorly known, etc.

2) The limitations of standard models and techniques have also become obvious the field of transfer payment impacts (impacts on labour force behaviour, on family formation and stability, etc.). Special difficulties and significant costs linked to the time span of the policies have resulted from the implementation of certain measures in areas ranging from health benefits to unemployment insurance, disability and poverty alleviation schemes. The capabilities for good long term forecasts in these areas require reliable models on both the demand side, for transfers on the part of potential beneficiaries (i.e. labour force behaviour, unreported income, poverty traps, etc.) and for the government adjustments, in practice, of eligibility criteria enforcement and evolution over time. Although the models though still unsatisfactory for the demand side, they do show promise; on in the second case, they simply do not exist at present. Other areas where change results from long-term trends and behaviour changes have also proved very difficult to handle; technological forecasts for instance are notoriously unreliable as are the calculation of the effects of regulations on firm hiring and firing powers.

3) Estimating risks linked to large scale operations of large public and private institutions in financial markets seems to have been beyond the analytical capabilities of present techniques although doubts still subsist as to whether the glaring disasters registered of the last decade in many OECD countries were truly unpredictable or if the policy system simply did not want to face the risks they would reveal, whether for want of analytic or organisational ability.

Not surprisingly, two of the three items just mentioned will reappear in the *Danger Zones* section. There are not many blind spots in methods but those that exist can be significant in terms of expenditures and economic impact.

### **2.3. *Distributive Interpretation and Consensus***

Distributive assessment exhibits limitations of certain impact assessment methods and can be partly attributed to the shortcomings of the methods themselves and partly to the difficulties in interpretation.

Solid models can routinely and accurately estimate who will pay and who will benefit from any given set of laws and regulations such as selecting an increase in VAT over one in income tax. This is less true, however, for tax on enterprises where the estimates are more fragile and more costly. However, the real issue is about what the numbers mean, how well they identify equity questions in politically useful ways, and whether or not they can be useful for decision-making, particularly when the complexity of the techniques and the ideas make the results and the way they have been obtained difficult to explain.

For instance, should progressivity of taxes, expenditures or regulations be estimated on present income distribution or on lifetime income distribution? Professionals in the field have opted for the latter long ago; the media, public opinion and politicians have not.

As for the use of distributive data, it has continued to suffer from the basic problem that such estimates literally generate organised opposition to virtually any change, that the clarity of numbers can easily lead to policy paralysis. Some regional or tariff problems also become unmanageable when very precise figures on potential winners and losers are available.

### **2.4. *Vulnerability and Manipulation***

However well established and standardised, methods for evaluating economic impacts of regulations or public expenditures are vulnerable to manipulations. This comes about essentially in forecasting adjustments by third parties (from changes in use of services with price changes to additional investments by firms receiving subsidies), in the valuation of benefits and costs when little direct observations of market prices exist (value of time and amenities, nuisances).

Somebody convinced that a policy initiative should go through (a ministry for instance) can relatively easily — without even resorting to blatant distortion — slant estimates toward the upper or lower acceptable bounds. The methods can seldom be defined or imposed in a precise enough fashion that it would eliminate these possibilities.

Consequently, the solution to this issue of vulnerability and manipulation is not to be found in the methods themselves but in the controls in the organisation of impact analysis.

### **2.5. *Conclusion on Methods***

To sum up, the issues about methods briefly presented here only nuance the basic feature of methods: tried and true ones do exist and are easily available on the market except in a few areas, which are important economically. Their utilisation depends more on a political choice than on availability. Foreseeing manipulations is essentially an organisational and system design issue.

### **3. Organisation and Structures**

This section deals with the supply of assessments and evaluations. The issues under this heading relate to how the system can *produce, on a regular and timely basis, analyses which are technically sound and relevant to legislative and regulatory decision making.*

Having good methods does not automatically lead to rigorous economic analyses. Here we will address how to manage and ensure a RIA and evaluations.

The perspective favoured in this section is that of small economies and public sectors with little or no tradition of economic impact analyses. The prescriptions on how to manage and insure the production of impact analyses is far less clear than the analytic methods themselves. How a public sector can be best organised to discharge its functions is less of an issue of technique than of judgement. The indications offered below on issues and on practices which seem to work best are based essentially on the experience of budget and financial reforms of the last decade and on the varied experience of evaluation and assessment in key OECD countries over the last generation. Morrall's paper presents the evolution of practices and their contexts in the United States, where the most progress has been made in systematising *ex ante* regulatory impact analysis. For this reason, this paper looks at other OECD countries because the lessons from all converge.

#### **3.1. Available Expertise and Resources**

In small economies where the tradition of assessment is short and the real resources scarce within the system, a certain number of choices have to be made. The first is to know whether to make models and create internal expertise or to buy external expertise.

The make or buy issue is a matter of degree. Building a minimum of internal expertise or creating at least a certain critical mass can virtually never be dispensed with. A cadre of civil servants must be available to manage contracts, to insure that outsiders temporarily hired for specific jobs adhere to the terms of the contracts. There are no real choices, however, when it comes to legislative initiatives or important regulations; internal personnel must be used to identify the issues and defining the mandates for contracted investigations and calculations. Except in special cases (actuarial calculations, technical aspects of modelling, etc.) an outside provider cannot be expected to translate governmental concerns into propositions for action. Most of these agenda items come up from responses to crises or promises made in very general election context. Thus, the first pass in defining relevant options has to come from people very close to the political decision centres who can know about which options might reasonably be expected to be examined systematically and how the results are to be presented.

Building up this core of trained insiders does not require hundreds of civil servants undergoing long and expensive training. First, if the decision is made to tap outside expertise, the numbers required inside are small. Second, if as noted in the first section, the methods are very standardised internationally, this is largely due to the fact that the methodological base for policy analysis comes from related disciplines (economics, systems analysis, etc.) where a large pool of people with the prerequisites already exists. Finally, international institutions and some research centres have developed a wide range of very accessible materials and courses; generally speaking, training organisations are all too happy to tailor their offerings to the specific needs of clients. Even for training the indispensable inner core of experts, it is relatively easy to have recourse to the international market.

On the make or buy issue, three phenomena are worth noting in the practices and development in leading OECD countries:

- Even in the largest economies, there is substantial and growing recourse to outside experts. Even in very large public sectors, impact assessment, from a managerial point of view is not a regular activity and typically one for which organisations can benefit from the economies of scale of specialised outside suppliers.
- The trend toward outsourcing has accelerated in recent years<sup>36</sup> in countries such as Canada, Australia, the United Kingdom, after a period when substantial resources had been expended in building up in-house capacity.
- Some indications point to increased internationalisation of the expertise market, particularly with respect to audit and assessment of firms to be privatised, the elaboration and running of large computer based simulation models, etc.

All in all then, the issue of available resources, even for small economies is unlikely to be the most important constraint. The situation is certainly brighter in this respect than it was 20 or even 10 years ago (larger market, cheaper technology).

This being said, contracting out is not a panacea particularly because it does not help prevent the manipulation of estimates. Indeed it lends itself to manipulation as much if not more (Lacasse, 1995) than in-house production. All the more reason to require in-house capacity mentioned above with respect to contract design and management as well as for inside quality and relevance control. Some experience, particularly in the United States, has suggested that part of these 'internal' functions could be handled through multi-tiered contracting out, some contractors would act as subcontractors for study quality control and relevance. It is still too early to pass judgement on this score, but the possibility is worth exploring.

A related but less critical issue is whether to invest in large multi-purpose models which could provide basic tools for many decisions. Stasse's paper illustrates how, in France, some sectoral models, for instance in the agriculture sector, are necessary to assess the ongoing changes in policies and environments like the EU's common Agricultural Policy. These are the sectoral equivalents of the indispensable macro-models which are everywhere required to assess and establish the fiscal stance, to negotiate with international organisations, and to send the right information to financial markets.

The decision as to whether or not to invest in tools of this nature as a matter of priority is largely a matter of political agendas and the fit between these tools and the problems on the horizon. In cases such as agricultural policies with the complexity of European integration, these tools are probably indispensable. The same can be said for dynamic simulation models to important foreseeable changes in national health insurance, for example.

It should be noted that a significant and competitive international market exists for setting up, tuning and running this type of model. Indeed, this is probably a more reliable and economical source in this case than of *ad hoc* policy analysis given the large stable firms which dominate this market and can provide for the necessary follow-up. Small countries such as Ireland and New Zealand have made extensive use of this option.

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36. *Managing Market-Type Mechanisms*, PUMA/OECD, 1995.

Again, recourse to the market for developing these often-used models which are very useful for ensuring the coherence of important projects like those linked to European integration is a solution but not a panacea. The more sophisticated the system contracted for, the greater the costs of changing supplier, the more inside control resources need to be devoted to contract management.

### **3.2. *Locating Production and Control Responsibilities***

These issues are crucial. However, OECD countries' experience does not lend itself to easy interpretations which could translate into "optimal structuring". The structures used have differed historically and continue to diverge. Failures have been noticeable in many cases, in part because of organisational and design shortcomings. Designs which have succeeded in some countries have not worked well in others. This being said, several lessons can be drawn from the successes as well as from the failures.

This subsection deals successively with the problems to be addressed in locating responsibilities for production and control, with a few features which are common to most systems which work well in terms of assigning responsibilities and trade-offs inherent in the conception of any system. Indeed, these compromises are inevitable and should be addressed at the very outset.

#### **3.2.1. *A Basic Problem and a Significant Imperative: Management and Control***

As signalled in the methods section, even the most solid and standardised techniques are quite vulnerable to manipulations and biases, often of a very subtle nature. Some practitioners (Moisdon) have even suggested as a standard operation that different researchers involved in the decisions produce their own conclusions in order to avoid pleas masquerading as "objective studies". In many large systems (urban transport planning, military) this is effectively what one observes. Other specialists (Kingdon, Reich, Lacasse, Rhoads) have documented how the very formulation of the problems that the political authorities are grappling with can slant the analysis of solutions which can be offered to decisions makers. The issue of insuring that the analysis offers the best that rigorous methods can offer is thus neither trivial nor susceptible to any definitive organisational "solution".

The key control issue is minimising biases and manipulations. Nobody contests anymore that line ministries, not because they are mismanaged or dishonest, but because they discharge their sectoral responsibilities, act towards the whole of government more often than not as lobbies, allying themselves with standard outside lobbies. A minister for agriculture who cannot say that he is defending farmers is usually an ex-minister of agriculture; the same goes for regional representatives. (Hausmann and Reisen). Totally decentralised responsibilities for impact or assessment studies seems necessary has **always** failed. A central authority responsible for controlling impact studies thus appears necessary and all evaluation or assessment systems in OECD countries are typically structured this way.

Beyond strict issues of control, locating central responsibility for RIAs and evaluations also involves the equally important issue of leadership. As policy agendas evolve together with the requirements for analysis, somebody must clearly be in charge for how RIAs and evaluations are to be undertaken, and responsible not just for administrating paper flows but for insuring the dynamism of the system, the continuous adjustments and improvements that need to be made. When launching the system this leadership role includes producing the necessary documentation on the methods and timetables, organising training, and being involved in nominations of key persons in ministries, etc.

This issue of central responsibility for leadership extends even further: the handling of thorny policy questions involving co-responsibility between the centre and the budget (long term evolution of transfers, unintended cross-impacts of one policy on another, etc.) involve setting clear responsibility for initiative in policy analysis and formulation which usually goes beyond the standard system duties of the budget or the centre<sup>37</sup>. Concretely, the need for authority and for central responsibility applies to methods as well as to politically sensitive issues: someone must be responsible for making sure that analyses are done and disseminated. As a result, the responsibility for choosing which studies to carry out should be clearly defined, institutionalised and centralised. This is what Mr. Morral points out for the case of the United States.

### 3.2.2 *Inside Players and Their Roles: Common Practices*

To eliminate the dangers of low quality and biased analyses, many systems responded by giving significant responsibilities for production and control to central organisations, linked to the budget or comptrollers. This has been the case in Canada, Australia, Denmark, etc., where for a while most evaluations and assessments were carried out centrally.

This centralised option was rapidly found wanting. Today only Australia still attempts to link evaluations to the budget cycle for instance and assign the Budget Office responsibility not only for leading but also for doing. Elsewhere, centralisation in or near the Budget Office landed analysis in the role of another episode in budgetary negotiations and too easily degenerated into a hide-and-seek game between the centre and ministries (on data for instance). The most important negative effects of centralised RIAs or evaluations is that sectoral expertise acquired by competent ministries goes unused whereas this is vital experience when it comes to identifying the problems or planning their solutions or defining the necessary studies.

The “solution” — and the rather standard organisational practice today — is to split the production and control functions. The policy initiator, generally a line ministry, is responsible for producing the analysis according to standards defined at the centre which also exercises quality control. In the case of RIAs in Canada for instance, the functions of the centre were to insure that the required studies were carried out according to the imposed standards and to make sure that they were published in the approved manner.

Numerous variants to this basic scenario can be observed. One of the most interesting is in the United Kingdom where, before a policy proposal can be presented to the Council of Ministers, it has to satisfy a series of very stringent requirements: complete long and short-term economic and budgetary impact calculations; examination of alternative delivery methods, indeed of different policies (regulation, legislation, privatisation, budgetary gifts, etc.) making it possible to meet the same needs and obtain the same results, cross-impact analyses vis-à-vis other institutions, regulations and legislation, etc. However, even in this exemplary case, it was necessary to have a special “Efficiency Unit” attached to the prime minister to launch reforms and the important public action and management evaluations.

Stasse’s paper shows how the French created a special central institution to exercise quality and relevance control in their latest attempt to introduce system-wide *ex-post* evaluation. The institution is responsible for verifying quality and relevance. The results were disappointing for virtually the same reasons as those in other countries that had initially opted for total centralisation: insufficient links between evaluation and the legislative and budgetary process. All things being equal, the same situation occurred in Canada in the 1980s. In a word, any centralised responsibility needs to be sufficiently fleshed out to ensure the relevance

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37. *Budgeting and Policy-Making*, SIGMA Paper No. 8, OECD, 1996.

and the political integration of RIA or of evaluations. Quality and relevance control are not sufficient conditions.

Locating production in line ministries and control cum leadership at the centre looks neat but is by no means easy to run effectively. For instance, in countries as different as France and Canada, very serious difficulties have been encountered in controlling from afar (i.e. from the centre) that planned evaluations stay on course according to the chosen orientations, that they manage to provoke research or bring to the fore unforeseen findings, and to identify and correct the design errors, etc.

These problems explain why, when impact analyses are structured in the standard fashion, “outsiders” such as audit organisations, “councils”, “commissions of inquiries”, “special task forces”, etc. have played and in many cases continue to play such an important role in the field.

### 3.2.3. *Indispensable Outsiders?*

The outsider status is defined here with respect to the standard executive institutions which make up the legislative, budgetary and regulatory streams. In all OECD countries except the United States, the legislature itself is not actively involved when it comes to defining policy options, producing or using analyses

Even if and in some cases because they are outside these executive institutions, bodies such as the National audit Office in the United Kingdom, the General Accounting Office (GAO) in the United States, the ESO group and the Audit Office in Sweden, etc. play a very important role in insuring that evaluations and assessments are carried out appropriately. Even more generally, the recent trend among Parliamentary Audit institutions is unmistakably away from compliance audit and toward one form or another of “value for money” audit which can be seen as a form of evaluation. Often, outsiders have taken the leadership in promoting analysis, in developing methods or in setting standards which ministries have later to follow. This is largely the case of the GAO in the United States.

The Swedish ESO is particularly interesting since, in a comparatively small country, it combines a quite original institutional set-up and a very open but very effective mode of control (Schubert 1996). It manages to combine the independence and transparency associated with recourse to outsiders and the relevance that comes with its being a part of the system. ESO is set up as a permanent Commission of Inquiry attached to the ministry of Finance; its board of directors is made up mostly of civil servants with a sprinkling of academics and union representatives who all serve in their personal capacity, but do not represent anybody but themselves. Their mandate is short. A small secretariat of 3 persons carries on the work.

The ESO's job consists in selecting and formulating policy questions which are then studied by outside researchers whose results are published with maximum publicity. ESO exercises no control over the outputs other than the quality of the research; it accepts or rejects a report for publication on strict technical quality grounds, the authors bear full responsibilities for these reports. ESO is only accountable to the Minister of Finance and ultimately to the Prime Minister on the same grounds: the quality and relevance of analyses. The effective control on quality comes from the wide diffusion of studies and the reactions of the ministries and interest groups, from the complete transparency of the process, indeed from the deliberate efforts deployed to insure as wide a dissemination as possible.

The organisation has played a key role in hastening legislation, improving debate and legislation in fields as diverse as agricultural subsidies, social transfers, health or the quality of local administration. It should

be noted that it intervenes somewhat early in the legislative or regulatory process which, rather than burdening the process, in fact helps strengthen it. When important governmental initiatives are at issue, systematic studies are even more useful when they take place before the problems and their solutions have been frozen and reduced to specific formulation which inevitably happens when legislative or regulatory proposals are drafted. The British evaluation system mentioned above also functions this way.

What can be read from this somewhat embarrassing fact that, time and again, outsiders occupy key roles in insuring that the analyses required by the legislative, budgetary and regulatory streams effectively takes place, *ex ante*, *ex post* or both?

My interpretation is that they occupy such an important place because they fulfil two basic needs: competition and independence, and perspective.

Competition/independence refers to the well-founded presumption that a single source of analysis and information, a monopoly—and a political one at that—does not retain credibility very long and is especially vulnerable to manipulation. Perspective refers to the basic fact that institutions like the Budget or the Prime Minister's Office are generally working on such tight deadlines and politico-constitutional imperatives that it is all too easy for them to become short-sighted and to have no time to integrate and even less to order or carry out the assessments or evaluations themselves. This leads us to the issues of inescapable trade-offs to be faced when setting up and running a system for impact assessment.

#### 3.2.4. *Trade-Offs*

Finding a balance between the quality of studies and timeliness is always difficult and goes beyond RIAs, evaluations or public administration (Moisdon). As a result, all systems have instituted important procedures to handle the issue of selecting proposed regulations and policy initiatives which should be subjected to various levels of impact analysis. Certain thresholds (financial) are easy enough to manage but problems arise when very little is known about even the approximate size of the possible impacts.

This happens particularly when regulations or legislation have no or little budgetary impact but may have significant economic consequences. For instance, substantially increasing the paper burden, the administrative costs and the uncertainties in obtaining approval to start a small business, strictly forbidding certain effluents, substantial changes in standards for imported goods and services are all initiatives with no direct budgetary impact but that can affect employment, production and prices in the economy. The last example is the American savings and loans disasters which occurred at the heart of the most complete RIA, partly because the regulatory changes in question attracted no one's attention for want of even summary indications of their future budgetary and financial impact.

The issue of selection criteria in policy analysis making it possible to deal with the trade-off between the quality of analysis and the timeliness of decisions also involves a specific trade-off in terms of risks. The issue here is to find the right balance between doing too much and too little. In cases like the ones evoked above where it is difficult to select initiatives requiring an impact analysis because there is too little reliable information about the economic importance of stakes, the temptation is to have the central authority impose a very fine net to filter policy initiatives, or in other words to virtually impose an impact analysis (or an *ex ante* evaluation) on all the initiatives or programmes. This amounts to wanting to reduce the risk of having a law or regulation adopted without informing policy makers about their probable consequences. This solution also has its risks.

The other side of the coin however is that systems which do not succeed in being selective in their requirements for assessments and evaluations run serious risks of not only overloading the decision-making system with unfeasible demands (Wildavsky) but also of inducing delays and paralysis which no legislative or regulatory system can tolerate for long. In other words, the risk in trying to insure that no significant measure will go through the net is to undermine the whole legitimacy of assessments and evaluations. The brave attempts of the Canadian evaluation system to fit all programmes and policies into a tight and fully planned system ended up to a large extent in evaluations being done but being also neutered into irrelevance.

### **3.3. *Trade-Offs, Objectives and Organisational Design***

Trade-offs have to be treated as basic constraints, the same goes for the permanent danger of manipulation or by-pass. Although, as mentioned, no model of organisation can pretend to carry with it THE SOLUTION, taking into account simultaneously the objectives, the trade-offs, the need for leadership and the risks leads to specifying some desirable features of the organisational set-up which stand the best chance of helping launch and expand a solid impact assessment and evaluation function. These features are to be added to those that are associated with mitigating or resolving the resources issues raised above.

These organisational parameters must conform to the following parameters:

1. A strong central leadership, perspective and authority.
2. An institution protected from the permanent emergencies of the centre and the calendar driven activities of the budget, remaining sufficiently independent while being very close to both institutions. This apparent paradox stems from the need to be both close to the co-ordinating governmental institutions without running too high a risk of being swallowed by their daily activities or being enmeshed in their negotiations with ministries. This set-up also has the advantage for the entire system of early analysis before the official position of the government or of the ministry has been defined officially or appears to have been defined as has been the case, for example, when a draft law has been revealed or made.
3. A small unit comprising civil servants detached from their ministries and often renewed.
4. Initial investment resources vested in the unit to allow for launching exemplary studies, encouraging training, etc. These resources should be subjected to a clear sunset clause: the unit should become a control and leadership locus with the main responsibilities for producing studies being delegated to the outside.

## **4. Demand and Use**

The choices about the methods and the organisation of impact analyses can be carried out successfully only if there is a demand for their outputs. The survival of the system depends on whether it is used and perceived to be useful to the political system. Demand and use issues close the loop. What is presented here in linear fashion is in reality closer to solving a system of simultaneous equations: not only the creation of a system of impact analysis, where it is located, how it is controlled and how it evolves will depend first and foremost on where the demand for it comes from, and from the needs it is meant to satisfy.

This section presents the issues of use in two steps: the first deals with what appears to be the key conditions for the system to start, to grow and evolve, to survive and exert influence on decisions; the second discusses specific analyses where the acceptance and use of results were slow and difficult, and where issues of legitimacy and presentation turned out to be delicate.

#### **4.1. *A Key Condition in Demand: Solid Institutionalisation***

No system for assessment or evaluation has seen the light of day without strong support at the centre of government or substantial and central political backing. This condition is in no way peculiar to the public sector: indeed, it is a banal pre-requisite that any substantial change in any large organisation requires support from the top, from those who wield power.

With the exception of one case (the United Kingdom of the 80s), no OECD country has had a prime minister or president who took such an interest in running and using the system that he allocated a substantial amount of time to it, continuously, over a long period of time. It is therefore fair to say that banking only on “the will of the prince” for starting an impact analysis and keeping it alive is a highly risky strategy, likely to depend on very exceptional circumstances for success.

The issue is thus to insure a much broader and stable support for impact analysis. One way to do so — observed virtually everywhere — is to institutionalise impact assessment, to tightly integrate it into the “rules of the game” in such a way as to impose large political and bureaucratic costs on all political and bureaucratic actors who would either abolish it or by-pass its rules.

The clearest example in this regard has been the case of environmental assessments of large projects. OECD countries have imposed on all promoters of these kinds of projects not only stringent demands in terms of analysis but have also given them more weight by forcing very open public consultation with all interested parties. In some cases, governments have gone so far as to financially help some groups that could be affected by the project but were too poor or too poorly organised to constitute significant countervails to the promoters.

However, the institutionalisation of requirements for impact analysis as a strategy knows severe limitations. The extreme case (in terms of costs and delays) of environmental assessments in large engineering project is clearly feasible only when there are few such projects on the agenda. And even then, there are signs that the pendulum is swinging back in some countries where, for instance, ingenious devices are being experimented with to reduce the costs, delays and immobility which have resulted from the system. Expanding the environmental model to a large fraction of governmental actions would induce paralysis and would not be tolerated long: the numbers of exceptions would grow or the whole process would be ritualised out of significance.

If institutionalisation is a necessary for insuring both control and demand, it faces a specific peril: ritualisation. Public administrations the world over have shown an extraordinary capacity to “digest,” without noticeable change, the most varied and stringent structural reforms embedded in the toughest regulatory language. The danger is so prevalent that it is worth discussing its nature and origins.

#### 4.2. *From Analysis and Debate to Rituals*

Since assessments and evaluations bring out information and perspectives which were not available when policy moves were initiated or policies put in place, they disturb the existing order of things, interests and habits. This function of questioning existing or intended equilibrium, of widening debate and in many case intensifying it, does not make it overly popular, anywhere. Since it also cause delays and since policy proponents or defenders, in any field, are already convinced that they, and they alone know all there is to know, opposition to impact analysis is unavoidable and widespread, both inside bureaucracies and among lobbies.

This opposition rarely manifests itself explicitly: nobody wants to appear to be against knowing more, improving legislation, regulations or budgets. All the more so since impact analysis, when introduced, is always backed by powerful instances in the Ministry of Finance and the Centre of government. Politically, the situation is virtually the same (knowledge=virtue) except when some can resort to the age-old argument that 'Enough of studies and delays, we know enough and it's high time for action.'

The opposition to impact analysis manifests itself not in declarations of war but by attempts to choke it. This most usual strategy, used by virtually all actors at one time or another, consists in going through the motion of impact analysis, of formally complying with all the requirements promulgated while making sure that nothing new or untoward can possibly emerge from the process, in making sure that the original intent or policy will come out of the examinations exactly as it went in, except perhaps for requesting more resources.

This ritualisation of the process has affected virtually every system which has been established. It is worth noting that one need not invoke the dishonesty or perversion of civil servants or politicians to explain the phenomenon as their motives can be as noble as hastening the "solution" to a problem, in perfect good faith, by arguing in favour of the legislation or the regulation proposed or defended. This only increases the dangers of ritualisation.

These perils are by no means theoretical. My own country, Canada, offers a good example. High levels of competence and expertise existed or were rapidly developed, in both programme evaluation and regulatory assessment; these functions had the backing of the highest authorities and were fully integrated into the decision making and management systems. Nevertheless, with hundreds of *ex post* evaluations carried out each year, the Budget Office found them totally unusable for its purposes, new governments had to launch new in-depth evaluations when they were searching for information on which to base their planned changes, and the whole review function is undergoing a fundamental re-organisation and re-definition. As for *ex ante* impact analysis of regulations, the very fact that most of the studies did not even attempt to assess benefits tells a story of dashed hopes.

The implications of these realities, in terms of setting up and running a system for impact analysis, are clear if difficult. First, to have a ritualised system is worse than having no system at all since it wastes resources, gives the wrong messages, provides illusions of rationality and good choices. Second, no definitive solution can be woven into the system against such an evolution; no rules can entirely eliminate it.

The only partial remedies and preventive measures seem to be:

1. a maximum of transparency and diffusion of studies to maximise the chances that ritual ones will turn into bureaucratic, professional and political embarrassments;
2. substantial independence and power at the centre to publicly deal with the “subtle” recalcitrants;
3. periodic re-examination of the functioning of the impact analysis system itself, the quality control it exercises AND the support it receives (or not) from the coherence institutions of governments at the centre of the Ministry of Finance;
4. an ever present selectivity, as proof of the link to true decisions and a condition of continuous adaptability (as seen above under organisation).

### 4.3. *Securing Allies and Clients*

A second strand to a strategy of establishing and allowing an impact analysis system to grow is to secure, nurture and expand its base of support both inside and outside the politico-bureaucratic system. This amounts to *finding incentives for various actors to be concerned with sound impact analyses*.

On this score, it is appropriate to examine the relationship in a public administration among impact analyses, the budget, and financial controls.

#### 4.3.1. *The Budget Office*

Curiously, in quite a few countries, the alleged natural allies of impact analysis — The Budget Office — has provided very little support, even when budgetary impact assessments occupied pride of place. This means that an impact analysis system which must carry a central government perspective has to rather carefully build its relations with the budget, without assuming that they “come naturally”.

There are several reasons for the lukewarm support of the Budget Office for RIAs and evaluations these need to be borne in mind when securing this essential support. Four related issues appear dominant:

- Budget Offices are lean, often overworked calendar-driven organisations. Consequently they are not likely to welcome additions to their workloads, however well intended.
- Economic impacts are **NOT** equivalent to budgetary impacts; indeed the very use of regulations has been stimulated by budget constraints since regulations often shift to other parties the costs of government initiatives, which comforts the budget. Budget Offices virtually never welcome the prospect of running a risk that assessments turn the proposed regulations into expenditures.
- The timing difficulties in scheduling evaluations in such a way as to use their results within the budget cycle have proven so severe that, with one exception, the efforts to directly integrate them to this cycle have been abandoned in OECD countries.
- Of necessity, the rules of the game in budgetary negotiations with ministries are well honed, highly functional with respect to the key objective of meeting the central objective of delivering an acceptable budget on time. Integrating new elements such as RIAs or evaluations into this

well-oiled bargaining system complicates matters, involves new players and additional delays. It is not surprising that budgetary directors are often resistant.

These issues are not insuperable. Their existence attests to the necessity of carefully making the Budget Office a party to the demand for impact analysis and of making sure that the standard imperatives of budgets are fully taken into account in designing the system.

#### 4.3.2. *Auditors and Comptrollers*

Another important source of support, another set of demands for impact analysis has come historically from those responsible for the control and audit functions on behalf of the executive or more importantly of Parliaments. This demand, evoked earlier under “organisation”, bridges the “inside and outside” divide in public administrations and raises the fundamental issues of legitimacy and public, political acceptability.

The development and expansion of audit and control function toward “value for money” audits and their demands that governments establish systems for insuring it *ex ante* are a relatively recent phenomenon. This trend is unmistakable and has been signalled above.

The importance of this demand stems from two factors. First these institutions, essentially reporting to Parliaments, enjoy a credibility often quite superior to political ones; second, it is in their interest as institutions to push for reforms favourable to the setting up and use of evaluations and assessments. Their institutional power and prestige can expand as their purview broadens.

The issues in harnessing this source of demand all revolve on methods, target strategy and independence.

The concern for independence is easy to understand for the power, credibility and distinction of these institutions depends on it. Consequently, they cannot be seen as direct partners, as is the case for the Budget Office. The modes of collaboration have to be indirect, “diplomatic”, generally focused on methods, on developing expertise and, delicately, on discussing criteria for assessing initiatives, existing policies and management.

The issues related to focus are thornier. These audit bodies traditionally are to find fault within public administrations and this is the source of a substantial part of the interest they generate in the media, the public and opposition politicians. The “horse on the payroll”, double billing, the disaster in an industrial project will certainly get bigger headlines than the learned opinion on the adequacy in structure and use of evaluations or assessments systems. This bias, which is alive and well, effectively sets up a perverse reward system for civil servants: it penalises risk taking and encourages formal compliance and rules-bound systems. Worse, from the point of view of using impact analysis, it distracts attention from the key stakes of marshalling expertise to design and implement policies and of introducing novel ways of reaching government objectives.

This issue is likely to remain alive. What can be done about it is probably to develop collaboration on the uncontroversial fronts mentioned above (methods, know-how, selectivity, etc.), to try to develop joint time tables for investigations of important initiatives or policies (e.g. before and after enactment), to try to get the auditors interested in how well ministries discharge their duties in producing assessments and evaluations, etc.

All in all, the issues here seem to dictate a strategy of collaboration with audit bodies which should focus on encouraging and assisting the trend away from strict compliance audit and, insuring that the agendas of these institutions are fully taken into account when designing an impact analysis system. This source of demand for it has become too important to be neglected.

#### **4.4. *The Heart of the Matter: Issues in Political Legitimacy and Usefulness***

Assessments and evaluations need support from political will. This is a key issue that determines not only setting up and expanding assessments and evaluations, but also defining their area and its limits. This in turn brings up issues of legitimacy and political usefulness: there are many requirements in being a politician, sainthood is not one of them. Unless the system is perceived as useful, it will not fly.

The issues linked to legitimacy of the methods and concepts used by impact analysis have surfaced most clearly in areas such as the value of life, safety and distributive matters. It should be noted that these issues are distinct from and additional to those dealt with in the methods section and arising from the shortcomings and limits of the methods themselves.

Morally, the value of any life is infinite and no life is more precious than another one. Putting a monetary value on life has been and continues to be repugnant to political discourse. In reality, governments are obliged to make choices on these matters, be it in allocating health resources (dialysis vs. prevention, heart disease vs. birthing and child health, etc.), passing or not transport and industrial safety regulations, etc. These trade-offs amount to putting a monetary value on human life AND on deciding that some lives are more valuable than others.

Since the impact of RIAs rests upon their influence on policy debates, on their capacity to bring out all the relevant facts in a systematic and explicit way, they suffer from the taboo on talking about the value of human life. As explained by Morrall, a substantial evolution has taken place over the years on this score. More importantly, he shows how the issue can be handled to take account of the repugnance in explicitly discussing it. The strategy involves setting such matters in comparative terms; for instance, in comparing various regulations stating impacts comparatively in terms of human lives saved by each option.

The second difficult manifestation of the legitimacy issue has surfaced in matters of safety. In its starkest form, the issue is simply that any impact analysis has to confront the belief, the illusion that such a thing as a 100 per cent safe, a 0 risk option does exist and can be bought or legislated. This attitude of course pre-empts a rational discussion of trade-offs between alternatives which impact analysis can compute and compare. It leads to futile and costly chasing of an illusion. The type of solution found in matters of value of life helps. However, a lot remains to be achieved before this issue can be put to rest.

The third important legitimacy issue which manifests itself inside public administration is the source of substantial resistance to impact analysis in line ministries. Some of it is simply that impact analysis adds to the workload, is unfamiliar, breaks the routine etc. i.e. that it is a change in existing equilibrium. This banal resistance, found in any organisation introducing changes, should not be confused with another questioning of impact analysis inside the bureaucracy: opposition to it because it renders management, the delivery of policies more difficult.

In a politico-bureaucratic environment, a line ministry has first and foremost to insure that the programmes for which it is responsible are delivered smoothly AND that the constituencies it is taking care of are reasonably happy. The greater transparency introduced by impact analysis, the involvement of players outside the traditional realm of the line ministry do indeed make management of its basic

functions more complex and more onerous. This is to a large extent unavoidable since one of the key outputs of impact assessment is to introduce considerations going beyond sectoral interests in the decision making process. Acknowledging this and the trade-offs which accompany it helps in designing and running such a system: at the very least, it prevents its promoters from attributing resistance based on real trade-offs among objectives faced by line managers with lack of virtue or competence.

Political decision makers find impact analysis useful if it helps facilitate choices between the claims of competing groups, to legitimise decisions to the electorate. This single dominant pay-off has clear implications. Without transparency and translation into public debate, the chances of success and survival are very small. Indeed, by providing a common language to assess claims on the State, by allowing more than immediately interested parties to participate in the policy debates, impact analysis is essentially a vehicle to widen the policy debate arena. It is certainly no accident that the most open system among OECD countries, the United States has been in the forefront of both evaluations and assessments.

#### **4.5. *Implications for Managing Impact Assessments Systems***

The various issues raised above on the subject of demand and use of impact assessments have only skimmed the surface of things. For instance, just in matters related to the transformation or what we might in many cases call the real “translation” of analysis results and methods so that they can be used by the political system and citizens, dozen of cases could have been added where significant efforts needed to be devoted not to the assessment itself but to its diffusion.

The same goes for demand building and seeking allies. The relations with the media (already stressed in the case of ESO), with lobbies, with public interest groups could also have been discussed. They are also important. For instance, the World Bank is presently testing a model making it possible in some cases to evaluate the quality of the budget on the basis of the press reports covering it.

The overall message for RIA and evaluation system managers is quite clear: as important as are the tasks of providing technical and organisational leadership, control and management, securing and retaining clients and allies is more important. So too is acquiring the reality and the appearance of independence and objectivity in studies.

### **5. *Danger Zones***

These areas have distinguished themselves in the recent past, in numerous OECD countries, by generating major “surprises” in financial terms i.e. unintended expenditures commitments and unwanted economic impacts which might have been avoided had serious assessments been carried out (or been used) before regulatory, legislative or budgetary initiatives had been acted upon. These rather sad facts are recalled not to illustrate the importance of assessments but rather to facilitate the identification of areas of policy initiatives where the need for rigorous analysis is greatest, even when not necessarily obvious at the outset, especially for public sectors starting up in the field of assessment and evaluation. As discussed under the “Organisation” heading, one of the key requirements of an efficient RIAs system is the capacity to sort initiatives, to identify, even the basis of little information, those which warrant expenditure and the time needed for an in-depth analysis. The following paragraphs provide a list of policy areas determined by the lessons of history as being dangerous.

### **5.1. *Guarantees and the Financial System***

From the disasters of the *Crédit Lyonnais* in France and the Savings and Loans in the United States to assorted expensive catastrophes of the same ilk in countries ranging from Norway to Japan, it would seem that the implicit and explicit guarantees to financial institutions have provided for the nastiest and most expensive surprises to governments over the last decades. Moreover, the damage done to entire economies has been substantial.

No government has deliberately chosen to incur such risks which only became known after the damage had been done. In virtually all cases also, control and satisfactory warning and redress systems seemed to have existed. In retrospect, one feature of these mishaps is striking: they never happen at the same time. Nevertheless, the warnings inherent in the well-publicised failures elsewhere were never taken into consideration as each system was probably complacent enough to believe that “it cannot happen here”.

Two systemic factors also explain how the persistence of this treacherous danger zone. First, even the best budgeting systems are relatively unprepared when it comes to including and monitoring explicit guarantees; second, the surprises came from institutions which, despite enjoying governmental backing, are very loosely or not at all controlled by the government. Independence is not a fault in itself: micro-managing a bank from a public administration is a recipe for paralysis. However, the balance between management autonomy and control — especially given full financial backing of the state — seems clearly to have tilted too far toward autonomy. The same problems were prevalent with a wide variety of State Owned Enterprise (SOEs) in the early 80s. A more satisfactory balance has been found since and current efforts will doubtless lead to the same results in the financial sector.

The size and brutality of the shocks endured in this domain means that any system for assessment and/or evaluation should almost automatically every opportunity to delve into the rationale for, the size and source of the risks involved in these institutions and guarantees.

The financial domain has been singled out here as providing a *prima facie* case for impact analysis because of the spectacular events observed there in the last decade. However the factors at work, with the exception of the speed of events, also exist in areas where normal control mechanisms (essentially budgetary ones) are weak. This means that large SOEs, all the off-budget guarantees (pensions, favoured enterprises, etc.) should also stand an excellent chance of being subjected to impact analysis in any filtering feature of a general system evaluation or assessment system.

### **5.2. *Inadvertently Creating Tradable Rents and Property Rights***

Contrary to involvement in financial markets, the problem observed in this field are almost always created by regulation aiming at solving a pressing problem, manifest themselves in the medium and long run, and create important budgetary and economic costs in addition to substantial political and social ones.

Typical of this class of phenomena are such “small” measures as giving assistance to taxi drivers, milk producers, cod fishermen, tobacco distributors, pharmacists, etc., via the instant creation of scarcity rents. For instance the number of taxis licenses are blocked, as are the number of fishing licenses, of milk production permits, etc. The intended populations indeed see their wealth increase. A few years later, the permits have been resold a number of times, their new owners have paid the full value of the rents conferred to the former owners, they are essentially as disadvantaged as those were before the

government's intervention. And any change such as increasing the number of permits etc. translates into real ruin for them. A blocked situation usually results.

The examples above are classic but the field is much broader as it often involves life-time employment guaranties, monopoly rights in numerous trades, etc. The problem is one of instrument choice: direct subsidies can be modified and producers given time to adjust, the amounts involved have to be explicitly budgeted and controlled. By contrast, when rents are created by regulation, no controls exist and the capacity to adjust later is severely restricted.

Impact analysis in such cases is of course much easier to carry out than in the case of financial markets and guarantees; its aims are more modest: to formulate and suggest to decision makers instruments which are more manageable and much less costly to adjust in the future.

### **5.3. *Transfers Systems Whose Costs Drift Away***

The last danger zone, i.e. a policy area where impact analysis should be applied unless solid evidence says otherwise, concerns transfers payments systems (income replacement granted under conditions of poverty, sickness/invalidity, death). The danger concerns less the immediate than the medium and long-term effects (on the economy and on public budgets) of programmes of long standing in OECD countries and whose impacts were supposedly well known, about which "best design practices" (e.g. a high degree of recipient selectivity and differentiation of levels of compensation and access criteria to achieve target efficiency, etc.) have been suggested and repeated for a couple of decades. Moreover, the management of these programmes had been deemed simple: controlling fraud and abuse in a regime where beneficiaries were exercising their rights to entitlements.

In recent years, research on the experience of numerous OECD countries has shown that these beliefs and certainties of yesterday do not fit the facts (PUMA 1995, 1996):

1. Most countries have experienced substantial drifts in expenditures which cannot be attributed to economic difficulties since the number of recipients does not decrease as expected when conditions improved, and the number of recipients of sickness and invalidity benefits go up together with improved health indicators.
2. Substantial porosity between programmes: when conditions of access to unemployment insurance get tougher, invalidity and poverty benefits experience acceleration in their growth despite the supposed independence and specificity of the various programmes.
3. Poorly explained drifts in expenditures and rises in the number of recipients of previously supposed water-tight programmes whose access was contingent upon meeting "scientific" criteria such as those used for sickness and invalidity.
4. The level of allowances and the eligibility criteria have a considerable effect on labour markets in a more and more clear way in most countries, as well as migration in certain countries. In both cases, it resulted in higher and more intractable measured unemployment.

These phenomena cannot be explained in terms of fraud and abuse but result from rational and unforeseen adjustments to opportunities and government incitation by recipients, and on poorly designed and predicted management of those transfers. The second factor is particularly vexing since it amounts to

substantial changes in government interventions taking place without having been willed or debated, much less submitted to any kind of systematic analysis. Using a central capacity for impact analysis is specially useful in this field since, in most cases, these programmes are designed and administered by different institutions and ministries who take little if any account of cross-impacts. Of course, the pay-offs to rigorous analysis in this case is not only economic and budgetary. Adjusting such social programmes is everywhere a major political and social trauma: all the more so since correcting these drifts affect profoundly the quality of life of people in weak positions to adjust and who count on such benefits as a permanent stream of income.

## **6. Conclusions**

At the end of this journey through the main issues involved in producing and using assessments and evaluations, some very clear conclusions emerge.

Setting up a system for impact analysis, running it and keeping it useful and relevant requires will, imagination and, even more, perseverance. There is no recipe for overnight success since the key constraints do not reside in a technology which can be bought but in managing economic and other expertise to improve the decision-making processes and the policies coming out of it. Since the relationships of knowledge and power have occupied some of the best minds since Plato, if it were as simple as applying techniques, this would have been known and done long ago.

To survive usefully, a system needs a good fit to its environment: this is utterly banal. However, some quite general requirements for success seem to emerge from the experience, the successes, shortcomings and even failures of various institutions and countries.

The “technical” requirements in getting expertise, building it, integrating its representative into an existing bureaucratic and political structure, even the organisational demands of setting up and running a system for selecting policy initiatives which should be submitted to very thorough analyses are all arduous tasks. They all have the merit of being reasonably clear.

As I have argued above, the most difficult part is to insure that the expertise, techniques, systems, etc. do indeed improve decisions and become part of the “rules of the game”. This has occurred in related fields: reading the discussions of macro-economic policies during the 30s or even in many countries during the 50s is a great help in measuring how much has been accomplished in bringing fresh knowledge to bear upon important decisions.

In this conclusion, I wish to single out two factors which appear important in this perspective and of which we too often lost sight in discussions dominated by techniques and management systems.

The first is what has been referred to previously as system transparency or openness. In mobilising knowledge for improving policy, this characteristic of the system may not only help improve democratic debate but could constitute a real requirement for effectively setting up and using an impact analysis system. This conviction stems not only from the observation that purely internal expertise is so much more vulnerable to manipulations and to the attendant dangers of losing credibility but also from the very simple example of how hard sciences evolve. If the “scientific” methods of social sciences have a contribution to make to policy, they must submit to the same tough competition and scrutiny hard sciences take for granted. A good policy analysis is really good only if those who might disagree can fully discuss it, if the scientific peers of the author, outside the system, can know about it and delight in dissecting it at

their leisure. Otherwise, it is merely a good piece of political advice whose claims to “scientific” rigour cannot be assessed and whose credibility is unlikely to survive long.

I borrow the second key factor from Schubert’s paper on Sweden’s ESO (the expert group on public finance which has had considerable success over the last 15 years in generating changes in policies and injecting the results of first class expertise in debates). When asked to explain the successes of ESO, internationally exceptional, Schubert stressed the quality and relevance of the reports, their good media coverage, institutional capability to remain both independent and creative as well as closely attuned to the political climate. If it were not for the modesty of the authors, he would have added as a key factor the high intellectual integrity, courage and devotion to the public good of those who directed ESO over the years.

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