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REGULATORY IMPACT ASSESSMENT: A TOOL FOR IMPROVED REGULATORY GOVERNANCE IN SRI LANKA?

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1. INTRODUCTION

Empirical evidence from around the world, as set out in analyses such as *Loayza et al (2004), Nicoletti et al (2003)* and *Estache (2004)* for example, suggests that good governance in general and regulatory governance in particular, are critical to a sustainable development process. A similar line of thinking is reflected in country-specific research carried out by entities such as the McKinsey Global Institute (MGI), which argues that India and Brazil could raise their labour productivity by 61 and 43 percentage points, respectively, if harmful rules were dismantled; and, that Russia could raise its structural economic growth rate to as much as 8 percent a year, without significant capital investment, if it had a more effective, competition-enhancing regulatory framework *(Beardsley and Farrell, 2005).* At a sector-specific level, studies by *Samarajiva and Dokeniya (2004)* and by *De Silva and Khan (2004)* find strong associations between the telecommunications regulatory environment and investment trends in Sri Lanka's and Bangladesh's telecommunications industries, respectively.

The literature also documents several studies that find positive links between strong governance and institutional frameworks on the one hand and growth in per capita incomes, increased investment etc. on the other, using quantitative indicators constructed for this purpose (see for example, *Hellman et al, 2000; Kauffmann et al, 1999, 2000, 2002*). As pointed out in *Minogue (2005)* however, the aggregate nature of the indicators that support these studies detract from the usefulness of the findings. Moreover, as argued in *Manning et al (2000)*, the indicators cannot determine an association between a particular type of reform and specific performance improvement and are also too generalized to be of any value in identifying the underlying causes of particular governance problems and coming up with practical reform targets.

The specific research and policy questions being explored in this paper deal with the extent to which regulatory impact assessment (RIA), defined broadly as:

"…an information-based analytical approach to assess probable costs, consequences, and side effects of planned policy instruments (laws, regulations, etc.)…[and] to evaluate the real costs and consequences of policy instruments after they have been implemented……a means to inform government choices: choices about policy instruments, about the design of a specific instrument, or about the need to change or discontinue an existing instrument." (Lee, 2002, p.12 citing SIGMA, 2001, p.10)

can usefully be employed in the development of practical regulatory reform strategies and in the pursuit of improved regulatory governance practices in Sri Lanka. The rationale for choosing a broader definition of RIA for this analysis is two-fold. First, given that the regulatory process is a complex, "messy" process involving several inter-connected policy variables, rather than a logical sequence of events, any analysis of regulation is complete only if it can be extended into the broader policy bowl. Second, in view of the strong parallels between regulatory governance and governance in general, lessons that can be teased out from the RIA process could provide valuable insights on broader governance issues.

As detailed in *Knight-John (2004a and 2004b)*, regulation in Sri Lanka has for the most part been incompatible with the needs of an economy and a society undergoing extensive reforms. In the case of privatization for instance – a process which was carried out rather extensively in Sri Lanka since the late 1980s- privatization often preceded the establishment of regulation, reflecting the prominence accorded to fiscal imperatives and leading to unfavourable distributional consequences *(Knight-John, forthcoming, 2005).* In addition, as set out in *Jayasuriya and Knight-John (2002)*, weak regulation coupled with privatization produced a huge source of continued rent-extraction for politicians and their cronies. Studies that document the general governance climate in the country also indicate an unfavourable situation, with Sri Lanka scoring 3.5 out of 10 on the international corruption perception index compiled in 2004 by Transparency International for 146 countries, the police being perceived as the most corrupt public institution in the country and nearly all Sri Lankan households surveyed admitting to bribing the judiciary *(Lanka Business Online, "Informed Choice", June 2, 2005 http://www.lbo.lk).*

Given the Institute of Policy Studies' (IPS) role as a leading socio-economic policy think tank in the country and its mandate to provide research-based policy input to the Government of Sri Lanka, the Institute set up a research unit dedicated to studying, evaluating and providing policy advice on problems relating to regulatory governance, competition policy

and public enterprise reform. It is in this context that the IPS in collaboration with its research partner, the Centre on Regulation and Competition, University of Manchester, initiated research, over a year back, on the opportunities and challenges associated with the introduction of RIA as a strategy for improved regulatory governance in Sri Lanka. In addition to working papers on the subject presented at various local and international fora, a significant feature of this research program was a two-day RIA Conference and Workshop for key stakeholders in the regulatory and policy space held in Colombo in June 2004.

A noteworthy outcome of these deliberations was the formation of an Informal Working Group, led by IPS and comprising experts from regulatory agencies, operators, the media and the non-governmental sector, to develop a Concept Paper on RIA for policy makers. The Paper was developed in a consultative manner in order to reflect, as far as possible, the views of a broad spectrum of stakeholders in the regulatory space. In April 2005, an interim version of the Concept Paper was published on the IPS website and comments were solicited by newspaper advertisements and a news clip on a widely disseminated online business site. In addition, an extremely productive Expert Consultation was held in May 2005, to discuss the findings of the Interim Paper, with comments from this session being incorporated into the final version that is to be handed over to the government.

The next Section of this paper sets out some crucial conceptual concerns pertaining to the use of RIA in a developing country, drawing also from the feedback received at the Expert Consultation on the RIA Concept Paper for Sri Lanka. Section 3 details salient issues in the Concept Paper and Section 4 concludes.

2. SOME KEY CONCEPTUAL ISSUES

As expounded on in *Minogue (2001, 2005)* the interest in regulation as a mode of governance has spawned a huge literature – largely relating to developed countries – on the regulatory state, regulatory space, regulatory capture, independent regulation etc. (see for instance, *Hansher and Moran, 1989; Majone, 1997,1999; Moran, 2002; Scott, 2000; Stern, 1997; Wilks, 1996).* The focus on RIA as a means of regulatory reform also has its roots in advanced economies, with the United States and Member Countries of the OECD spearheading the process and research on the subject as it relates to a developing country context still at an embryonic stage. Analyses by *Kirkpatrick et al (2004)* based on a questionnaire with leanings towards the OECD approach, administered in a sample of developing and transition economies, and by *Jacobs (2005b)* on the role of RIA in the

democratization process in selected transition states in Central and Eastern Europe, indicate that whilst there is a growing awareness of the concept, its application is patchy and inconsistent.

The fundamental research and policy question is why; why has the spread of RIA been so limited in less developed countries? Is it an issue of policy transfer where the "international best practices" promulgated by the OECD do not sit well in economies that strive not only towards greater efficiency in resource allocation but also towards reducing poverty? Or is it a "chicken and egg" dilemma where RIA requires a pre-existing level and genre of "good governance" that is not present in developing countries. Conversely, can RIA facilitate the creation of islands of good governance amidst oceans of bad governance? As raised by *Lee (2002,p.21)* citing *Radaelli (2002)* does the rational-synoptic and technocratic perception of the policy process implicit in the OECD's RIA template *"lead to impact assessment systems which crash against the walls of administrative feasibility, lack of legitimacy and proliferation of instruments badly assimilated by civil servants and politicians"* given the messy nature of policy making where interest groups politics and patron-client relations drive and shape the decision-making process.

Although precise answers to these posers requires concrete applied research – perhaps through a series of case studies – in a developing country context, it is worth highlighting the cautionary note contained in *Minogue (2005, p.25)* echoing the notes sounded by *Levy and Spiller (1996)* and citing *Majone (1991):*

> *"The notion that regulatory models established in developed economies can be transferred into a contextless environment is clearly a dangerously naïve conception, and there may well be a need to adapt idealised models of regulation to particular variations between national, political and administrative cultures, so that an adaptive process must be specific to each national regime".*

What is significant in this regard and in relation to the RIA research being carried out in the Sri Lanka is that a persistent concern expressed by the various stakeholders commenting on the Concept Paper, was the applicability of this methodology in developing countries in general and in Sri Lanka in particular. To cite one of the participants at the Expert Consultation, whose views were reiterated by several others present,

"An approach of looking at 'best practice' elsewhere and applying it here won't work or sell. We need to do it the other way around – look at the 'holes' in our regulatory governance and then identify practices that can be tailored to stitch these up. The mechanism maybe RIA – or it maybe some other regulatory reform approach. But we must not rush into adopting blueprints".

A related concern aired at the Expert Consultation was the feasibility of adopting the quantitative requirements – or the cost-benefit component- of the RIA method as set out in the processes followed in the advanced economies, given the significant data and technical inadequacies in the country. It was pointed out that basing an RIA on erroneous data would distort the decision-making process and have counter-productive consequences for regulatory reform. As reflected in an article titled "The Regulator's Best Friend?" in the *Economist, March 31st, 2005*, which claims that Europeans embrace the logic of cost-benefit analysis just as Americans grow suspicious of it, players in Sri Lanka's regulatory space are perhaps not alone in their wariness. According to the article, the Centre for Progressive Regulation, a think tank, asserts that cost-benefit analysis is *"fatally flawed and intrinsically anti-regulatory"* alleging that it *"works like a kind of universal solvent. It breaks qualities down into quantities, differences in kind into differences in degree, gold into base metal. A safe childhood, a breathtaking view, a clean pair of lungs – all are reduced to fungible 'dollar-equivalents'"*.

Whatever the case for cost-benefit analysis maybe, the redeeming feature for RIA is its inclusion of the process element – where for instance, consultation procedures can be used not only to enhance transparency, accountability etc. and incorporate principles of good governance but also as an assessment technique. As such, RIA could be employed usefully through mechanisms such as perceptions surveys and focus groups, in countries such as Sri Lanka where quantitative methods have a weaker base.

3. RIA CONCEPT PAPER

As mentioned in the introductory section of this paper, the RIA Concept Paper developed to be handed over to the government was the result of a consultative process involving a number of stakeholders from the regulatory and policy space. This section sets out some key elements of the Concept Paper. Before proceeding to details of the Paper however, it should be noted that whilst Sri Lanka does not have a formal RIA process in place, there have been two significant attempts at incorporating this approach in a partial manner – one

embedded in the Regulatory Manual of the Public Utilities Commission of Sri Lanka and the other in the Deregulation Process undertaken by the Public Interest Program Unit set up by the previous government to spearhead the reform process. However, a change of regime and the associated reversals of policies, which have now become a regular feature of governance in Sri Lanka, prevented further progress in this area.

The definition of RIA adopted for the purpose of the Concept Paper, taken from *Lee (2002)* is:

"a process used to assess the likely consequences of proposed regulation, and the actual consequences of existing regulations, to assist those engaged in planning, approving and implementing improvements to regulatory systems".

Whilst recognizing the value of using a broader definition of RIA, as specified in the introduction of the piece, the Group that compiled the Concept Paper was of the view that emphasizing RIA as a tool for regulatory reform – as against its potential as a tool for broader policy reform – at least at this initial stage, would bring about less resistance from vested groups and be a better "marketing strategy" as far as the government was concerned.

In setting out the objectives of RIA in the Sri Lankan context, the Concept Paper emphasizes the role of RIA as a tool for pro-poor growth (equity) and enhanced regulatory governance, and argues that the wellbeing of the citizen has to be at the heart of the process. This citizen-centric approach is reflected in the boxed examples set out in the Paper, ranging from the obstacles faced by farmers as well as investors due to inefficient land legislation, the hardships faced by businesses because of a badly conceptualised Economic Service Charge, the loss of revenue to the country with the illegal by-passing of international traffic given inadequacies in the International Traffic By-Pass Control Rules and the threats to consumers and small businesses with the "politically-motivated" stripping of monopolies and mergers provisions from the competition law.

The Concept Paper deals rather extensively with mechanisms and options for the institutionalization and implementation of RIA in Sri Lanka, as set out below:

- In the short to medium term RIA should be targeted and developed at the Central Government level, given the need for endorsement at the highest political level. As previous experience with reforms in Sri Lanka indicate, it is easier to introduce new

processes at the provincial and local government levels, if legitimacy has been established at the centre. As such, the Paper proposes an incremental approach, starting with the Centre and gradually moving into the other levels of government using strategies such as Pilot Studies that have local relevance.

- Given the need for political endorsement at the highest levels, the Paper suggests three options for the location of a central RIA unit: the President's Office, the Cabinet Office and the Ministry of Finance. Whilst the latter was chosen because of the central, coordinating role it plays in the development process and the links it has with all the other subject Ministries, one pertinent concern that remains is the possibility of fiscal imperatives taking precedence over other objectives of RIA if the Ministry of Finance overlooks the Unit.

- An issue for decision-makers set out in the Paper is the duration of the unit's life- specifically, if it ought to function as a sunset unit that fades out as RIA practices get progressively embedded in the regulatory culture of the country or whether there is justification for a continuing entity to provide for oversight and guidance. If the latter approach is adopted, a recommendation for the medium to long-term is to convert the unit into a separate legal entity, under an Act of Parliament and with the involvement of the Constitutional Council in the appointments procedure.

- The mandate for the RIA unit is to establish standards for regulatory quality and principles of regulatory decision-making, and to provide the necessary support to the line ministries and regulatory agencies that will in turn carry out RIAs. This requires the formulation of an RIA template to guide the decision-making process. The Concept Paper sets out the need to address the following when developing a template:

  ✓ The role of RIA in achieving sustainability and poverty reduction goals;

  ✓ The timing and extent of public consultation in an RIA and processes for co-ordination within government; and,

  ✓ Coordination of RIA with more narrowly focused impact assessment processes such as EIA and SIA. The aim should be to generate synergies while avoiding costly duplication and/or contradictions.

In addition, the Paper emphasizes the usefulness of qualitative methods such as perceptions surveys and focus groups in developing a methodology appropriate for Sri Lanka.

- In order to rationalize time and resource costs associated with the implementation of this process, the Concept Paper also suggests that RIAs should be confined to those regulations that have the most significant positive and negative distributional or efficiency impacts. The Paper outlines the following screening criteria for this purpose:
    - ✓ Identify the key stakeholders affected by the proposed regulation (for example, consumers, businesses, investors, regulators, law enforcement authorities), together with a rough quantification (e.g., x number of businesses)
    - ✓ Identify the potential impacts, positive and negative, on each of the key stakeholders (e.g., for business – additional costs to be incurred to comply with the regulation, for consumers – better safety standards, for regulators – increased costs of monitoring compliance)
    - ✓ Considering the above two points together, give an impact rating of high, medium or low to each positive/negative impact
    - ✓ Where one or more impacts are rated as "high", or two or more impacts are rated as "medium", it would be advisable to undertake an RIA.

- A practical issue of concern highlighted in the Concept Paper, requiring the urgent input of key decision-makers, is the need to coordinate the RIA process with the already well-established Environmental Impact Assessment (EIA) process and a Sustainable Impact Assessment (SIA) process that in on the cards. Whilst analyses of RIA in the United Kingdom (UK) (see for example, *Jacobs, 2005a)* indicate that the departments responsible for EIA in the UK were willing to place these under the RIA umbrella, given the broad and flexible nature of the RIA process, it is likely that there will be significant resistance to such an approach in Sri Lanka which is replete with examples of turf war in the policy space. These anticipated problems with coordination coupled with the fact that the EIA process in Sri Lanka is in itself a rather fragmented and haphazard one, could create significant obstacles to the effective implementation of RIA is they are not tackled at the very outset. As expressed at the Expert Consultation for instance, it is vital that the powers in charge of regulatory reform establish some ordering or sequencing for the application of these different methods, to prevent a situation of regulatory overkill.

- Clearly, technical capacity would be a priority for the RIA unit and it would need to be able to attract high quality professionals in order to fulfil its mandate effectively. In this regard and in order to have the flexibility to pay market based salaries, the

Concept Paper recommends that the RIA unit be exempt from the standard Administrative and Financial Regulations that govern public sector entities, whilst adopting a transparent operations manual that should be open to public inspection to ensure adherence to principles of accountability. The Paper calls for the setting up of a multi-skill professional base in the unit, drawing from the fields of economics, engineering, law, and ideally also sociology and environment, with staff being recruited on a full-time basis. Moreover, it is recommended that the organizational structure should be skills-based, with team-work being accorded priority, minimal hierarchy, and outsourcing and contracting out given precedence over staff expansion to preserve a lean entity.

- Once the RIA template and screening criteria have been established, the Paper suggests that a Cabinet decision requiring that all Secretaries to Ministries, Heads of Departments and Chairmen of Authorities that exercise regulatory powers undertake an RIA, before placing any new regulation that meets the predetermined screening criteria, for Ministerial signature. To underpin this, it should be further required that the draft regulations and their accompanying RIAs should be submitted to the unit for review, and the non-binding opinion of the unit obtained with a specified number of days, before the regulation can be passed. Moreover, it is recommended that the unit publicizes its opinion in order to enhance transparency and accountability and improve regulatory governance.

- Finally, the Concept Paper sets out cases that have a direct impact on the population as possible Pilot Studies, as a practical strategy to solicit political and broader stakeholder buy-in for the RIA process as well as to identify through applied research, the opportunities and challenges associated with the use of RIA in Sri Lanka. The identified cases are: Amendments to the VAT, cess on vehicles imports, Private Health Services Bill (being drafted) price control formula on drugs, Calling Party Pays Tariff, price control of "specified goods" by the Consumer Affairs Authority.

4. CONCLUSION

The importance of building "well-governed" institutions based on "international best practice" to promote growth and to reduce poverty has become a much chanted mantra in the donor community (see for instance recent editions of the World Bank's *World Development Report*), with this ideology being transferred to developing countries through donor-funded programs and through the influence of policy makers and academics trained in institutions that promote the Bretton Woods line of thinking. Whilst recognizing that good governance is indeed critical to the sustainable development of a society and an economy, the pertinent questions remain: what is good governance and what is "best practice"; can what is defined as good governance in developed societies or a version of it be assimilated into a developing country context; if not, what are the specific factors that need to be taken into consideration in attempts to improve governance practices in developing countries?

For example, the focus on governance is more rhetorical than real in Sri Lanka, in spite of recent attempts through donor funded projects to improve governance and regulatory governance, largely due to the configuration of interest groups and rent-seekers that benefit from maintaining the status quo. This raises significant doubts, for instance, as to the robustness of the concept of 'independent" regulation as defined in the context of well-governed societies in countries that have weak governance structures. As argued in *Samarajiva (2002),* "workable independence" maybe a better way to conceptualize the issue in developing countries. Moreover, as highlighted in *Minogue (2005)*, public policy – including regulation – is inherently a political process; as such, regulatory strategies have to be attuned to political nuances if they are to be effective and not result in implementation deficits.

As set out very eloquently several years ago by *Downs (1957),* politicians and civil servants are seldom interested in reforms that produce results several years hence. It is the political electoral cycle that matters even in developed societies such as the United States. This phenomenon is more pronounced in countries like Sri Lanka where dissolving of parliament, fresh elections, and *ad hoc* changes in ministerial portfolios and civil servant positions even without regime changes are frequent occurrences. This brings on a whole new dimension to the reform process and to getting deep "buy-in" for reforms such as RIA which could take several years to demonstrate results. More often than not, such reforms are taken on board merely to satisfy donors with little commitment from those that implement it, resulting in a patchy and distorted application of the process.

The issue then is to develop strategies that blend with the vote-maximization objectives pursued by politicians and that do not pose a threat to the position of civil servants. One solution – which is one adopted in the RIA Concept Paper developed for Sri Lanka- is to aim for "buy-in" from a broad spectrum of stakeholders, putting the citizen at the centre of the process by doing pilots on cases that affect the average citizen. This strategy has the twin benefits of being able to evaluate the opportunities and challenges associated with RIA in Sri Lanka as well as being palatable to politicians and decision-makers that cater to the general masses, even for their own self-interest. In the final instance the key question is: what is the counterfactual; what is the situation in the absence of RIA; can regulatory governance be improved if RIA becomes established in Sri Lanka's regulatory culture? It is to seek concrete answers to these questions that further research, beginning with a series of pilots, is necessary.

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