Rationale for intervention

Summary and key points

This document aims to provide a guide to developing the rationale for intervention for regulation in impact assessments (IAs). Establishing the evidenced rationale is fundamental in the policy making process to justify a potential solution to the problem under consideration. The RPC does not comment on ministers' policy choices but will assess the quality of the evidence and analysis underpinning this choice. If the existence of a problem has not been identified, it is highly likely to result in an IA not being fit for purpose at consultation stage.

The document first summarises existing Better Regulation and Treasury (Green Book) guidance on developing the rationale for intervention. We reference Treasury guidance on the various problems that could form the basis for a sound rationale – this includes market failures but also other potential rationales, particularly distributional considerations. The guidance emphasises the importance of clearly identifying why change is necessary to identify specific objectives or outcomes the government wishes to meet through intervention.

The document then provides advice on linking policy options to the problem and clarifies what the RPC will and will not comment on in relation to proposals linked to manifesto commitments. Finally, the document provides guidance on the RPC's expectations when it scrutinises evidence and analysis for the rationale. The document uses a review of cases submitted to the RPC and comments in the opinion on the department's consideration of the rationale, drawing out key themes and providing new case study examples. These themes include applying market failure concepts and distributional considerations to the rationale; and linking the preferred option to the problem being addressed. It covers rationale where the preferred option might not have the highest monetised NPV. Examples are presented from a number of departments and policy areas, including transport, energy, environment and health.

Introduction

This 2020 guidance updates the 2016 case histories guidance on the rationale for intervention in (regulatory) impact assessments (IAs). The guidance covers:

1) **Better regulation framework interim guidance:** Existing guidance from the Better Regulation Executive (BRE);
2) **Treasury Green Book guidance on rationale:** The guidance discusses how the principles also generally apply to regulatory IAs;
3) **Applying the framework and RPC expectations:** Practical advice for providing a rationale and highlighting RPC expectations;
4) **Linking the options to the problem:** Practical advice on linking the policy option to the problem under consideration;
5) **Manifesto commitments:** What the RPC will and will not comment on; and
6) **Issues raised during RPC scrutiny of departments' consideration of rationale:** A review of more recent RPC opinions/comments on departments' rationales, with new case study examples.

1) Better regulation framework interim guidance

The better regulation framework (BRF) interim guidance (March 2020) describes the rationale for government intervention as the first stage of regulatory policy development. The guidance states: *"Policy development should consist of two stages: identifying the rationale for government intervention; and appraisal of the options to deliver the Government's policy intention." (paragraph 1.1.1, page 10).* The guidance then states: "*Identifying the rationale for government intervention should follow HMT Green Book guidance. Generally, identifying a market failure would serve as the rationale for intervention." (paragraph 1.1.2, page 10).*

A clear rationale forms the basis for evaluating an adequate range of policy options (*covered in separate case history guidance*) and that the lack of a clear rationale could result in poor policy option design. Further, if a consultation stage IA has not satisfactorily demonstrated a rationale for intervention, the IA would normally not be considered fit-for-purpose.

2) Treasury Green Book guidance on rationale

Chapter 2 of the Green Book, ' *Introduction to Appraisal and Evaluation'*, notes that a rationale sets out clearly the purpose of the intervention and should explain how intended changes in outcomes will be produced by the recommended delivery options. It provides a list of possible objectives of a proposal, such as to improve the efficiency or quality of a service provision. The document also notes that it is "…*vitally necessary to be clear that the rationale may also be to improve the welfare efficiency of existing private sector markets, for example by making polluting organisations maintain standards and meet the cost of remediation to retain standards. It may also concern achievement of ethical distributional objectives for example fair access to health or education. It might involve providing social/public goods that are not provided at a satisfactory level by the market alone, for example justice services or social services*." (paragraph 2.10, page 7)

It can, therefore, be a misconception that the rationale for intervention for a regulatory or other measure must be supported purely by demonstration of a market failure. We discuss distributional considerations and other non-market failure rationales below, and provide case study examples for these later. It is important to note that the rationales presented in the guidance is from a selected list of the most common types of rationales for intervention presented in IAs. The guidance does not intend to advise that the rationale for intervention needs to fit into any of the categories presented in this section. Nevertheless, market failure remains a frequent rationale for intervention and asking whether there is a market failure is a question that should normally be asked when considering a regulatory or other intervention.

Market Failure

Market failures are common bases that underpin the rationale for intervention and one where there is an extensive theoretical underpinning for intervention. The Green Book explains the type of issues that can affect the ability of markets to allocate scarce resources efficiently (paragraph 4.23, page 29). Generally, as indicated in the BRF guidance, an underlying market failure could serve as the rationale for intervention. Examples of market failure are summarised in the box below).

Treasury Green Book: Market Failure

The Green Book defines 'market failure' as "… *where a market is unable to function fairly according to the economic ideas of efficient markets, from a Green Book perspective which looks beyond simply economic efficiency this means the market is unable to provide satisfactory levels of welfare efficiency*" (glossary, page 133).

Examples of some causes of market failure include:

Public goods: Many aspects of the environment can for example be described as public goods, for instance the benefits of clean air. When provided it is unavoidably available to all. It is non-excludable in supply and once provided, it matters little how many people enjoy it. It is therefore non-rivalrous in demand. These features make clean air impossible to supply on a commercial basis.

Imperfect information: Well-functioning markets require buyers and sellers to both have perfect information about what is on offer and about the other bargains being struck in the market, that is about quality and price. An imbalance in the information available known as information asymmetry confers an unfair advantage on the side that possesses it.

Externalities: These occur when an activity imposes costs or produces benefits for economic agents not directly involved in the deal. For example, pollution not covered by regulation may be profitable for a perpetrator but impose real costs on others who are not directly involved in the market.

Market power: This results from insufficient actual or potential competition where either sellers or buyers have an unfair advantage. It can arise from too few buyers or sellers, as occurs with monopoly and oligopoly among sellers or through collusion by sellers in anti-competitive behaviour. Problems can also arise from monopsony, i.e. where there is effectively only one dominant buyer. Barriers to market entry and exit can also cause a concentration of market power.

Source: HMT Green Book 2020.

Distributional / social welfare objectives

As noted above, the Green Book notes that rationale may also concern the achievement of ethical distributional objectives. Possible different types of such considerations are presented in the box below. There could be distributional, equity or social welfare concerns that might lead policy-makers to consider market outcomes sub-optimal and a department could propose regulation at least partly based on such factors. For example, government intervention could be proposed on equity / social mobility reasons, such as widening access to education, to help vulnerable people in society (such as disabled or ill people) or to reduce wage inequality.

Distributional effects and proportionality

The Green Book states that distributional effects may apply to defined income groups, household types or types of business. At the longlist (of options) stage, they may be a constraint on the feasibility of some options. Appraisal of distributional effects should be proportionate to the likely effects on those affected (paragraph 4.19, page 28). At the shortlist of options stage, the Green Book states that where distributional effects (e.g. on income) are relevant, they should be appraised. Assessment of distributional impacts could range from a simple quantitative or descriptive approach where the scale of the effect is relatively low, to an in-depth appraisal and detailed calculation of distributional effects where the scale is relatively high. Depending on the scope and type of intervention distributional analysis may involve considering the impact on businesses of different size, for example focussing on small and micro businesses (paragraph 5.68, page 54).

Small and micro-business assessments (SaMBAs) are a better regulation requirement in impact assessments on significant domestic regulatory proposals. The RPC has produced guidance for departments on carrying out SaMBAs.[1]

Distributional or social welfare considerations:

If a regulation has a redistributive objective or if it is likely to have a significant impact on different groups, distributional analysis serves as a useful method to quantify the impact and strengthen the evidence underpinning the rationale for intervention. Distributional considerations might include:

- Income. Based on the principle that the value of increased income may be higher for a low-income recipient than a high-income recipient. Therefore, policy-makers might attach greater weight to income gains or losses to lower income individuals or households.

- **Access to public services, such as healthcare or education**. Fair access for different groups of people to public services can be proposed on equitable or social mobility reasons such as widening access to education.

-**Risks.** A CBA will value the risk reduction to workers or the public using standard techniques. Even where the CBA concludes that the cost of the risk reduction exceeds the benefit, policy-makers may determine that this cost is not 'disproportionate' given the level of risks to particular groups of workers or the public.

The Green Book provides guidance on distributional analysis (for example, on income). Where these are relevant and significant, distributional weights[2] can potentially be applied to costs and benefits. This is based on the principle that the value of increased income may be higher for a low-income recipient than a high-income recipient. Where it is applied, this analysis should be presented alongside the conventional Net Present Value (NPV) figures (i.e. not in place of them): *"Presentation alongside the overall UK effects improves visibility and transparency of distributional impacts, so that the effects of decisions are properly understood and, where necessary, options for mitigation may be considered." (paragraph 5.38, page 54).* Where such weightings are applied, equity advantages of a proposal should not be 'double-counted' in the non-monetised benefits section.

Tolerability of risk

There might be other examples where a straightforward comparison of costs and benefits does not necessarily fully capture the merit of a proposal. For example, the HSE's Tolerability of Risk framework uses the concept of 'reasonably practicable' to assess and evaluate a given risk against the costs and benefits of proposed intervention to reduce the identified risk. The framework advises that proposed regulation to reduce risks to tolerable levels should be informed by evidence and be based on what is reasonably practicable (an example of such regulation is reviewed in section 5). In

[1] https://www.gov.uk/government/publications/small-and-micro-business-assessment-samba-guidance https://www.gov.uk/government/publications/rpc-case-histories-small-micro-business-assessment-august-2019.

[2] *"Distributional weights are factors that increase the monetary value of benefits or costs that accrue to lower income individuals or households. They are based on the principle that the value of an additional pound of income may be higher for a low-income recipient than a high-income recipient." (The Green Book, paragraph 5.70, page 54).*

these cases, a proposal with a negative NPV could be justified if the level of risk to individuals (workers and/or public) is high enough.

Other considerations for the rationale

There may also be some other considerations such as the precautionary principle or implications of international/EU measures that could form the basis for the rationale of intervention (covered in the box below). Case examples of these are covered later in the guidance.

Other considerations

Interventions needed to ensure legal compliance: For example, international or EU obligations may serve as the rationale for intervention because UK intervention would be necessary to avoid breaching international law or commitments. It also might be the case that existing international policy is not consistent with domestic law.

Reducing unknown risks: In some instances, the precautionary principle could potentially be used to support a policy intervention where there is uncertainty about the nature and extent of the risk. (See 'precautionary principle' example later)

To provide an economic rationale it is usually necessary to identify the specific problem that the regulation is aiming to address, for example, an underlying market failure or distributional concerns. As noted above, the Green Book states that the rationale should explain how intended changes in outcomes will be produced by the recommended delivery options. This implies there should be a clear link between the intervention proposed, the problem under consideration and whether the intervention will achieve the objective. The Green Book states that a lack of clear objectives negates effective appraisal, planning, monitoring and evaluation and that objectives must be "SMART", i.e. specific, measurable, achievable, realistic and time-limited The identification of objectives in this way is a crucial part of the rationale (paragraphs 4.9-4.10, pages 25-26).

SMART objectives are necessary for effective monitoring and evaluating of the impact of regulations. The Magenta Book goes into detail about the importance of evaluation in the policy making process: *"The outputs and learning from earlier evaluations should be fed in at the rationale and objectives stage, when the issue to be tackled is being explored" (section 1.4, page 12).* Therefore, an insufficient rationale could lead to a lack of clear objectives which would subsequently limit effective appraisal, planning, monitoring and evaluation.

Understanding the status quo or 'business as usual' (continuation of current arrangements without intervention), or more accurately the 'do nothing', by evidencing the consequences of inaction, can help provide a rationale for intervention. The overarching policy appraisal framework is set out in the Green Book. The main elements of the policy cycle are described as Rationale, Objectives, Appraisal, Monitoring, Evaluation and Feedback (ROAMEF). (See page 15 of the Green Book). The framework implies that a clear rationale for intervention informs all stages of the policy making process.

3) Applying the framework and RPC expectations

At consultation stage, the IA should answer the question "*What is the problem the proposal is seeking to address?"* Departments should use the conceptual frameworks described in the Green Book to articulate the problem being addressed. Evidence should be presented as to the problem's existence and its scale, drawing a distinction between perception and reality where the two diverge. The Department should also provide evidence and/or strong logical argument that the problem identified will not be corrected by market forces alone.

At final stage, the IA should still explain and evidence the rationale for intervention, particularly if the RPC did not provide scrutiny of the IA at consultation stage. Establishing a sound economic rationale for intervention using robust evidence of the problem would help provide justification for a policy recommendation.

4) <u>Linking the options to the problem</u>

Once the rationale for intervention has been established and evidenced, the IA should then answer the question: *"how does each of the proposed interventions address the problem?"* There should be a reasonable expectation that the intervention would address the problem. The IA should explain how each of the options presented will provide a solution to the problem identified. Where the link between the problem identified and the impacts of the options is not clear, the RPC is likely to recommend that a clear link between the two is established or include a wider consideration of options.

Policy options (covered in separate case histories guidance) presented in the IA should be supported by analysis that explains how each option would provide a partial or complete solution to the problem(s) identified. This would involve discussing and comparing the twin priorities of achieving the objectives of the intervention and providing a solution to the problem identified.

5) <u>Manifesto commitments</u>

This section explains the RPC's role in scrutinising impact assessments (IAs) where the rationale for intervention is based on a manifesto commitment.

In drafting IAs on proposals based on manifesto commitments, departments commonly undertake an assessment of the rationale for intervention and alternative options.

Manifestos usually include both outcome commitments and specific policy commitments:

- Outcome commitment: Where the manifesto commitment is to achieving an outcome and/or is of a broad policy nature, the assessment of delivery options will be necessary. Impact assessments should be objective and not aimed at providing an analytical case for a pre-determined course of action; and
- Policy commitment: Where a department's rationale for a proposed measure or choice of option is significantly affected by a manifesto commitment, or a prior ministerial decision, this should be made clear in the impact assessment.

In general, the RPC expects Departments to consider multiple delivery options. However, in the case of a policy commitment, if other options in the IA are not genuinely being considered as alternative courses of action, this should be presented transparently to avoid potentially misleading, for example, stakeholders. Overall, where departments consider that presentation of an IA with a single option is the most appropriate approach, the reasons for this should be made clear. Prior engagement with the RPC would be particularly valuable in these situations.

In either case, we would still expect a department to undertake a proportionate assessment of the impacts of different potential options. The RPC would expect the option with the highest NPV to normally be the preferred one in the IA. A specific commitment in a manifesto may be a legitimate explanation for choosing a policy option that does not have the highest NPV (especially where there are significant non-monetised impacts or desired outcomes). However, the IA should express the policy objective in terms of the underlying problem being addressed by the proposed measure (i.e. the purpose of the manifesto commitment rather than simply its delivery), rather than merely repeating the manifesto commitment itself. There is no regulatory equivalent of the 'ministerial direction' for spending proposals but departments should make clear the basis of any preference for an option that does not have the highest NPV.

Spending proposals can often follow manifesto commitments and the Treasury's 'five case model'[3] is the required framework when considering the use of public resources. Regulatory IAs follow the same logic as spending appraisals and can often benefit from considering the five case model. The model may be particularly helpful in relation to policies relating to manifesto commitments by drawing out the strategic case more clearly and joining together the other elements into a coherent whole.

RPC's role in scrutinising these IAs

The RPC's role is to provide independent scrutiny of Departments' IAs underpinning regulatory interventions. The RPC does not comment on the merits of policy, which is a matter for ministers. This principle applies regardless of whether the policy is tested in the democratic process through the government's election manifesto. However, we do comment on the quality of the explanation and analysis of the rationale for intervention.

The RPC's principle of not commenting on policy has two aspects:

- Policy objectives: The RPC will comment on the clarity and completeness of the description of the rationale for intervention and the evidence and analysis supporting it but not on the merits of the policy objective itself; and
- Policy choice: The RPC will comment on the identification of the policy's impacts and the assessment of the costs and benefits of each option (including any missing impacts, costs, benefits, etc.). If the preferred option does not have a higher NPV than all of the other policy options analysed in the IA, the RPC may comment on this fact but only in the context of whether the IA's assessment supports the option preference (and not on the policy choice itself).

RPC comments on rationale for intervention and options

Consultation stage

Detailed consideration of the rationale for intervention and options is particularly important at consultation stage (and is required under the Better Regulation Framework). To be fit for purpose, a consultation stage IA will need to include satisfactory consideration of the rationale for intervention and alternative options.

[3] https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent. See pages 18-22.

Final stage

Final stage IAs would also benefit from proportionate consideration of these areas. It is best practice for final stage IAs to include rejected short-list options in the IA's summary sheets. As a minimum, the main body of the IA should summarise options that the department considered at consultation stage and why they have been rejected. To assist RPC scrutiny of final stage IAs, where a department chose not to submit the relevant consultation stage IA for RPC review (formal or informal), it would be particularly valuable if the final stage IA included sufficient information on these areas. (The final stage IA can reference the consultation stage IA for further details to avoid repetition.) The RPC may well comment on the evidence and analysis supporting the rationale for intervention and the consideration of options in the final stage IA, particularly where it has not seen the consultation stage IA. However, under the current Better Regulation Framework, our overall rating of final stage IAs is not affected by its consideration of the rationale for intervention and options.

6) Issues raised during RPC scrutiny of departments' consideration of rationale

This section highlights case study examples of issues raised during RPC scrutiny of the rationale in IAs. Since 2018, departments have not been required to submit consultation IAs to the RPC. However, many departments voluntarily submit consultation IAs to the RPC to receive an informal assessment and advice, to improve the consultation stage IA and/or assist the development of the final stage IA.

Applying market failure concepts to the rationale for intervention

The RPC is looking for departments to identify and evidence the rationale for intervention, often using market failure or other concepts covered in the Green Book guidance. In the example below, externalities were identified as the market failure and the rationale for intervention was strengthened by improving the assessment of the counterfactual.

The Ecodesign for Energy-Related Products (consultation stage IA & final stage IA; BEIS-4413)

The proposal was to update existing eco-design requirements for external power supplies (EPS) in line with those that will apply in the European Union in the event of the UK leaving the EU without an agreement. EPS are contained in a physical enclosure outside of the electronic device in need of charging; they are used to power a variety of electronic devices ranging from mobile phones to laptops. The main objective of the proposal is to improve the energy efficiency of EPS, reducing energy bills for households and firms.

The Department's consultation stage IA noted that manufacturers may decide to comply with EU and US standards regardless of the UK's actions. The IA also monetised significant net whole life cost savings to consumers. The IA would benefit from further discussion of what businesses might do in a 'do nothing' counterfactual, in particular incentives facing EPS manufacturers to bring in the new standards without regulation.

The final stage IA included further discussion of market failures (negative externalities that arise from carbon emissions) and the likely counterfactual. On the latter, it was explained that, in the absence of intervention, manufacturers would be unlikely to bring in new EPS because their main incentive was on price rather than whole life cost.

The examples below articulate clearly the evidence for there being a problem that needs addressing. It also evidences the market failures to ascertain that the problem will not be corrected by market forces alone. Providing sound evidence to demonstrate an identified market failure helps establish clear government objectives for the regulation. In the first example, the Department identified market failures associated with market power, externalities and imperfect information.

Extending competitive tendering in the GB electricity network (final stage IA; BEIS-4464)

The proposal was to enable a body appointed by the secretary of state to tender licences competitively for onshore electricity network assets. The measure extended competition to new, high-value and separable onshore electricity transmission network assets. The proposal intended to introduce new parties to the market, address the information asymmetry that exists between Ofgem and the network companies it regulates and introduce competitive pressure on the large onshore electricity network.

The Department's final stage IA provided a thorough overview of the market failures which persist and provides a detailed background to evidence the problem under consideration. The three market failures identified were: a) Market power and barriers to entry arising from a monopoly regime of incumbent network operators; b) Imperfect information arising from a mismatch of information between Ofgem and the companies regulated; and c) Forgone positive externalities that are associated with competition.

In the example below, the Department aimed to address the external costs associated with the disposing of plastic drink stirrers.

Proposal to ban the sale and supply of plastic drink stirrers in England (final stage IA, DEFRA-EA-4317)

The measure was to implement a ban on plastic stirrers in England. The main objective of the proposal was to help to protect the environment for future generations, improve the quality of the environment and reduce harm to human health and wildlife. The ban intended to ensure that drink stirrers were no longer plastic, but made of materials that will decompose much quicker.

The final stage IA provided a clear rationale for intervention by explaining the externalities associated with plastic drink stirrers. Specifically, when plastic stirrers were disposed of, the social costs (environmental harms and carbon emissions) were not accounted for within the market price of plastic drink stirrers.

Further, providers of drink stirrers did not have incentives to address the externality costs and the Department explained that the ban was expected to encourage businesses to invest in cleaner alternatives to plastic. The ban also intended to increase consumer and business awareness of the environmental harms drink stirrers caused after use and to signal the Government's intent to reduce unnecessary plastic waste.

In the examples below, the Department provides evidence that the problem would not resolve itself without government intervention to correct the external social cost associated with pavement parking and pedicabs. In the latter example, the regulation intended to also resolve the imperfect competition associated with pedicabs.

Pavement parking restrictions (consultation stage IA; DFT)

The proposal was to enable safer use of the pavement by all pedestrians and to reduce consequential costs to local authorities arising from damaged pavements and personal injury claims. The consultation IA was seeking views on whether improving current processes might be sufficient to address problematic pavement parking and noted that the preferred option will be decided at the final stage.

The consultation stage IA provided a well evidenced rationale by assessing the consequences of inaction and indicated that unnecessary pavement parking would not resolve itself without government intervention. The Department highlighted that pavement parking occurred because pavement-parking motorists did not face private costs equivalent to the external social costs (negative externalities) imposed by pavement parking and drew on evidence from other countries to inform the rationale for government intervention.

Regulation of Pedicabs in London (final stage IA; DFT-3558)

The measure grants powers for Transport for London (TfL) to implement a licensing, and right to work check, regime, with similar characteristics to the taxi and private hire vehicle sector that would provide safety standards and enable effective enforcement of pedicabs (rickshaws) in London. The main objective of the measure was to set the appropriate safety standards for pedicabs and their drivers and improve general traffic management.

The final stage IA presented evidence to suggest that pedicabs have a disproportionate effect on traffic congestion and tend to congregate in pedestrian areas, which can have an impact on other road users. The Department also presented evidence which suggested that pedicab drivers are not transparent about the higher fares they charge and were charging different prices to different customers. In discussing the rationale, the IA explained that the market was affected by both imperfect competition and negative externalities, given the lack of transparency and consistency of pedicab fares.

Applying distributional / social welfare considerations to the rationale

In some cases, regulation might be deemed necessary to address distributional or social welfare concerns. In the example below, the Department presented the rationale for intervening with a national living wage mainly on equity factors, specifically, with the aim of reducing wage inequality. Note that this was different to the rationale for the national minimum wage, which was based mainly on market failure. The difference between the two is illustrated by acknowledgment that achieving the NLW objectives involved a trade-off, with the OBR originally estimating that 60,000 jobs could be lost.

Amendment to the National Minimum Wage regulations 2020 (final stage IA, BEIS-4443)

The measure implements increases to the National Minimum Wage (NMW) and the National Living Wage (NLW) based on recommendations from the Low Pay Commission (LPC). The recommendations are underpinned by extensive consultation and analysis, carried out by the LPC. The main objective of the measure is to ensure protection for low-paid workers, whilst also providing incentives to work and reducing reliance on the benefits system. Further, the objective of the NLW has been to reach 60 per cent of median earnings in 2020 - this means that wages of the lowest paid will rise relative to the middle of the wage distribution.

The final stage IA provides detailed economic rationales for both wage components of the measure. The economic rationale for the NMW is to address market failure caused by monopsony market power.
The Department presents a broader rationale for the NLW centred around equity – primarily to reduce wage inequality and address the possibility of employers exploiting the vulnerability of certain workers to pay them unacceptably low wages. The NLW also aims to ensure low-paid workers aged 25 and over are fairly rewarded for their contribution to the economy.
The IA also presents evidence which suggests that the NLW has increased pay at the lower end of the labour market without harming employment.

The example below includes an equity consideration in the rationale for intervention; to help low-income households with their energy bills by reducing energy consumption through energy efficiency measures. The example also applies income distribution weights from the guidance in the Green Book to value the distributional impact of the main policy options. It is another example of a measure with twin objectives: an environmental one (to reduce carbon emissions) and to reduce fuel poverty, and with a trade-off between the two. The trade-off being that carbon reductions could be delivered more cost effectively without the constraint on energy provider discretion that gears measures towards low-income households.

Energy Company Obligation ECO3: 2018 – 2022 (final stage IA, BEIS-4226)

The measure extends the Energy Company Obligation (ECO) to the end of March 2022. The measure placed an obligation on larger energy suppliers to achieve both carbon and bill savings by promoting and installing energy efficiency measures into homes. It also extended eligibility to households on disability benefits and households in receipt of child benefit below an equalised income threshold of £25,500. The main objective of the measure was to drive uptake of energy efficiency measures in the residential sector among low income and vulnerable households in or at risk of fuel poverty.

The final stage IA presents key market failures in the domestic energy efficiency market including access to capital, misaligned incentives, asymmetric information, and externalities. The IA also include a section on equity considerations and explain that intervention is also justified on grounds of equity by tackling fuel poverty. The IA uses evidence from the Marmot Review report on cold homes and health to set out evidence linking low temperatures to poor health outcomes and explains the Government proposes to focus ECO3 on low income, vulnerable and fuel poor households.

The Department includes detailed cost-benefit analysis of the impact of the measure and applies equity weighting to reflect the distributional considerations of the policy. The IA assesses that equity weighting tends to increase both the costs and benefits of the policy, with a more significant increase in benefits because benefits are focused on lower income households. This represents a potential trade-off between the policy objective of reducing the cost of carbon emissions and the equity consideration towards low-income households, where the cost per reduction in carbon might be higher.

HSE's Tolerability of Risk framework

As noted above, there might be instances where a proposal has a negative monetised NPV because the value of the risk reduction is lower than the cost of reducing it (see section on explaining the rationale for policy choice when the preferred option does not have the highest NPV). However, a straightforward comparison of costs and benefits might overlook potential cost-benefit trade-offs and distributional considerations in terms of high risks being faced by particular groups. In the area of workplace safety, the HSE's Tolerability of Risk framework may be relevant. This framework provides for consideration of the level of risk facing workers (or the public) being factored into the policy decision. Departments should present evidence of the risk identified when providing the rationale for a measure that aims to reduce risks. The example below applies the concept of 'reasonably practicable' to assess and evaluate the risk against the costs and benefits of proposed intervention to reduce the identified risks as low as is reasonably practicable.

Small Fishing Vessel Code 2020 (consultation stage IA; DFT-4429)

The Maritime and Coastguard Agency's (MCA) proposal was to introduce a mandatory set of safety standards for small fishing vessels. The 'Small Fishing Vessel Code 2020' lays out safety standards for all fishing vessels of 15 metres or less. The code which will be enforced by the MCA, included requirements related to survey and inspection; construction, watertight and weathertight integrity; stability; machinery and electrical installations; fire protection; and protection of personnel.

The consultation IA provided evidence from HSE that estimated the rate of fatalities to crew was around 43 deaths per 100,000 fishermen working on UK registered fishing vessels in 2017/18. In the discussion about the rationale, the IA explained the challenges the fishing industry faced in reducing risks to a tolerable level for society. Further, the heterogeneous nature of the fleet coupled with different ownership and operating structures had led to information asymmetries between crew and owners/operators about levels of risk faced while at sea.

The preferred option in the IA had a negative monetised NPV, with the cost of risk reduction exceeding the value of the risk reduction. However, following RPC scrutiny, the MCA produced a revised IA which drew on the tolerability of risk framework, which indicated that the level of risk to workers was at a level where the proposal could be justified even where the costs exceeded the benefits (using standard monetary values for a prevented fatality).

Changes to existing policy

In the example below, the Department notes changes to national security risks and technological and economic changes, including certain innovative technologies developed by new start-ups or small companies, that fall outside the scope of the current regulation. In the example below, there was a rationale for intervention but not necessarily a 'market failure' one.

National Security and Investment Bill (final stage IA; BEIS-4172)

Through the National Security and Investment (NS&I) Bill, the Government aimed to strengthen the national security of the UK against risks arising from changes of ownership and control of entities and assets. The proposal introduces a mandatory notification regime for sectors which pose the greatest national security risk and a voluntary notification regime for all other sectors. The proposal aims to reform government powers and systems for mitigating national security risks arising from acquisitions are appropriate and proportionate to the current and evolving threat. The Bill also amends the Enterprise Act 2002 to allow co-operation between UK and overseas public authorities for the purpose of merger investigations. This amendment intends to facilitate co-operation between the CMA and public authorities in other countries and lead to better decision making and enforcement in a cross-border context. The Department's final stage IA explains that national security is a public good, which leads to private costs & benefits to differ to social costs & benefits.

The RPC's opinion included a number of comments on the IA's explanation of the rationale and indicated that the IA would benefit from providing greater evidence to demonstrate the existence of the problem, the necessity of intervention and the sufficiency of the specific measures proposed in solving the problem identified. In particular, it suggested extended analysis or explanation for the public goods/externalities argument presented for national security risks, particularly as it was not clear that national interest and allocative efficiency were aligned in this case.

Linking the options to the problem under consideration

A common issue that the RPC raises during scrutiny of the rationale is how the options relate to the problem under consideration. Where the link between the problem identified and the impacts of the options is not clear, the RPC is likely to recommend that a clear link between the two is established at the consultation stage, as in the example below.

Extending the 5p charge for single use carrier bags to all retailers and reviewing the minimum 5p charge levied to at least 10p in England (consultation & final stage IA; DEFRA-4325)

The measure was to increase the current 5p mandatory charge for single use carrier bags (SUCBs) to 10p for all retailers. The main objective of the of the policy was to contribute to the commitments set out in the Resources and Waste Strategy to eliminate all avoidable plastic waste by 2042. The measure was also extending the charge to small, medium and micro (SMMEs) retailers to reduce the SUCBs in circulation and to reduce greenhouse gas emissions and litter associated with SUCBs.

The Department's consultation IA referenced the 2015 IA (which introduced the 5p mandatory charge for SUCBs) to provide assumptions which underpinned the evidence base for this measure. Due to the time elapsed since the previous IA, the IA would benefit from providing new evidence to support the rationale for extending the measure to SMMEs and to also support the preferred choice of the 10p charge. The final stage IA improved its evidence base and the rationale discussion in the IA, which provided a clearer link between the overarching policy objective and the preferred option.

The case examples below relate to a strategic government policy to reduce childhood obesity in the UK. Strategic policies are likely to have more than one regulatory measure to address the problem under consideration. Departments should provide a clear link between the specific measure and how it aims to contribute to the wider strategic aim of Government policy.

Mandating Calorie Labelling of Food and Drink in Out-of- Home Settings (final stage IA; DHSC-4216)

The proposal was to develop a mandatory calorie labelling scheme across all large businesses in the out-of-home sector (i.e. any outlet where food or drink is prepared in a way where it can be consumed immediately). It was intended to provide consumers with consistent energy information that will help them make informed choices. It also aimed to encourage businesses to reformulate existing products and design new recipes with lower energy content.

The IA outlined existing issues relating to more children who live in deprived areas consuming more fast food due to the greater availability of such food and the difficulties parents have in making restaurant decisions. The Department strengthened its assessment of the rationale by clearly setting out that the policy objective would help to reduce fast-food consumption amongst children as it aimed to reduce calorie consumption in the out-of-home setting as opposed to a specific type of food outlet. The IA explained adverse selection arising from information asymmetry as a key market failure that needed to be addressed and how previous efforts of encouraging the provision of calorie labelling in out-of-home settings had been unsuccessful.

Introducing a watershed on TV advertising of HFSS (food and drink that are high in Fat, Salt and Sugar) products and similar protection for children viewing adverts online (consultation stage IA)

The measure aimed to limit when HFSS (food and drink that are high in fat, salt, and sugar) products can be marketed on television and online platforms. It intended to reduce the likelihood of children consuming excess amounts of HFSS products, purchasing these products directly or influencing family purchases of these products. The proposed options aimed to reduce childrens' exposure to HFSS advertisements and provide incentives to food and drink manufacturers to advertise healthier products within their ranges or reformulate their products to be healthier. The consultation stage IA outlined negative externalities from excessive consumption of HFSS products to support the rationale for intervention. The IA also cited the societal costs associated with obesity. The IA would benefit from providing further evidence to support the rationale, by focussing on how the potential option(s) will specifically target childhood obesity, which was the wider policy objective of the measure.

Banning the sale of energy drinks to children (final stage IA; DHSC-4302)

The proposal was to ban the sales of energy drinks to children under the age of 16. It was intended to restrict overconsumptions of high-caffeine energy drinks by children. The main objective of the measure was to mitigate the potential negative effects associated with the excessive consumption of energy drinks by children.

The Department's final stage IA explained that consumption of energy drinks by children had been linked to low physical, psychological, educational wellbeing and sleep disturbances. The IA also noted that many larger retailers and supermarkets had voluntarily stopped selling energy drinks to under-16s, but other retailers continued. The RPC, therefore, asked the Department to strengthen the rationale for regulating before the impact of the voluntary ban had been fully assessed.

The RPC also recommended that the Department could improve the rationale by using clearer evidence to support the rationale for intervention, specifically by demonstrating the causal link between caffeine consumption and negative health. Providing clearer evidence to support the rationale for intervention would also create a clearer outcome-based objective for the problem that needs addressing.

Using evidence and economic appraisal to link the option to the problem

The example below highlights how providing evidence to support the rationale can assist in developing a clear link between the regulation and the problem identified. The Department improved its evaluation of the consequences of inaction to support the rationale for intervention. Providing clearer evidence to support the rationale would also create a clearer outcome-based objective for the problem that needs addressing.

Restricting the use of tyres on the front axles of heavy vehicles (consultation and final stage IA)

The proposal was to ban tyres aged ten years or older on the front steered axles of heavy good vehicles, buses and coaches and all minibus axles where tyres are in single configuration. The main objective of the proposal was to improve road safety by reducing the possibility that collisions involving HGVs, bus, coach and minibuses occurred due to old tyres.

The Department's consultation IA noted that the rationale for the ban was that guidance in place has not been effective enough. The IA explained that asymmetric information had influenced heavy vehicle operators' tyre replacement decisions and the existence of a negative externality in tyre replacement on heavy vehicles. The IA would benefit from providing further evidence to support the rationale for intervention and specifically on why the preferred option was chosen and how it links to the rationale.

. The final stage IA strengthened the rationale for intervention by discussing the chosen option in greater detail through using an alternative counterfactual to inform the analysis.

<u>Explaining the rationale for policy choice when the preferred option does not have the highest NPV</u>

The RPC does not comment on ministers' policy choices but will assess the quality of the evidence and analysis underpinning this choice. The RPC looks for a clear statement in the IA on which of the options discussed is preferred, a clear justification for this choice and how it aims to solve the problem under consideration. In most instances, this will be on the basis that the economic appraisal suggests that such an option is likely to be the one with the highest monetised net present value (NPV), i.e. the most net beneficial or least net costly to society.

However, the RPC recognises that there will be cases where departments can justify a preferred option that does not have the highest monetised NPV. In this case, the RPC would expect a clear demonstration of the existence and scale of any potential non-monetised cost/benefit factors, such as affordability, distributional considerations or any potential wider economic and societal impacts.

Improving the energy performance of privately rented homes in England and Wales (consultation stage IA)

The consultation IA was seeking views on the Government's proposal to further amend the Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015. The proposal was to place a responsibility on landlords to meet an EPC C target by 2025 (new tenancies) and 2028 (all tenancies), subject to a cost cap of £10,000.

The IA indicated that additional efforts were required to make progress against the statutory fuel poverty target and to deliver against the legislated net zero 2050 carbon target.

The consultation IA provided a detailed assessment of the rationale, highlighting a range of market failures and barriers to energy performance improvements in the domestic privately rented homes sector (PRS). For example, incomplete information about the benefits of energy improvements, misaligned incentives, and externalities. The primary rationale was that regulation would be necessary to overcome the misaligned incentives that are prevalent in the PRS – where the costs of energy improvements fall to landlords, but tenants are the main beneficiaries.

The IA provided a range of alternative options to meet the policy objectives. The Department's preferred option was estimated to have a lower monetised NPV and smaller contribution to reducing fuel poverty than one of the alternative options. The final stage IA would benefit from setting out explicitly why the chosen option was preferred, such as affordability considerations for landlords.

There may also be cases where the NPV of the preferred option is negative, implying that it is inferior to the 'do nothing'. In most cases, this will be because wider societal benefits have not been monetised. If so, the IA should make this clear.

Measures for introduction of E10 fuel stream (consultation stage IA)

The consultation IA explained that ethanol is a biofuel that can be blended into petrol to reduce greenhouse gas emissions. In the UK, petrol is currently blended with no more than 5 per cent ethanol (a formulation known as E5). Increasing the percentage to 10 per cent is expected reduce CO2 emissions from petrol cars.

The consultation IA provided a detailed explanation of the need for government intervention, referring to 'first-mover disadvantage' arising from fuel suppliers being unwilling to be the first company to roll out E10 because E5 fuel is more efficient and could result in a loss of business. The IA also notes the role of competition law preventing a non-regulatory solution, such as, fuel retailers supplying E10 in a coordinated and uniform way.

The preferred option in the IA had a negative NPV which was underpinned by the assumption of the Renewable Transport Fuel Obligations (RTFO) targets remaining unchanged for the duration of the appraisal period. The Department noted that if the RFTO targets increased, the preferred option would have a more significantly negative NPV. The IA would benefit from explaining further how the measure was consistent with delivery of broader policy objectives and related measures (such as carbon budgets and net zero) and how a positive environmental impact of this particular proposal would be demonstrated by drawing upon non-monetised impacts.

See also the 'tolerability of risk' discussion and example above.

Other possible rationales to support government intervention

In some instances, the precautionary principle could potentially be used to support a policy intervention. The RPC has produced a guidance note that sets out the factors that the RPC will look for in impact assessments where the precautionary principle is cited as a key rationale for intervention. If a Department decides to invoke the precautionary principle in support of the rationale for intervention, departments would still be expected to demonstrate a sound economic rationale for intervention by using evidence to support the use of the precautionary principle. Using an example that was covered earlier in the guidance (*Restricting the use of tyres on the front axles of heavy vehicles*), the Department strengthened its explanation and evidence in relation to the use of the precautionary principle.

Restricting the use of tyres on the front axles of heavy vehicles (consultation and final stage IA; DFT-4386)

The consultation IA noted potential safety concerns arising from old tyres being fitted to heavy vehicles and provided evidence which suggested that old tyres on heavy vehicles had been deemed as a contributory factor at the Coroners inquests covering two collisions that resulted in eight fatalities over a ten-year period.

The Department explained that the preferred option in the consultation IA had been chosen as a precautionary principle. The RPC suggested further clarification on how the measure falls within the parameters of the precautionary principle guidance. The final stage IA improved its assessment of the rationale by including a section on the use of the precautionary principle. The Department strengthened the rationale by providing further evidence of the irreversible harmful effects of, and the level of scientific uncertainty, associated with the use of old tyres on HGVs.

Measures necessary for legal compliance and EU / Other International measures

Regulatory provisions may implement new or changed obligations from EU or other international regulations, decisions and directives. International or EU obligations may serve as the rationale for intervention because UK Government intervention, in some cases, would be necessary to avoid breaching international law or commitments. In cases where the international obligation serves as the rationale for intervention, departments should explain the overall objectives of the international policy and the underlying merits (or otherwise) of the measure for the UK. Where UK implementation goes beyond that required to meet the minimum international obligation, the rationale for this extension should be explained clearly (and ideally evidenced by a monetised net benefit).

Falsified Medicines Directive - Implementation of the Safety Features elements (final stage IA; DHSC-MHRA-3704)

The EU Directive implements safety features to prevent harm to people in the UK from falsified medicines by reducing the occurrence of falsified medicines in the legitimate supply chain. The proposal to comply with the EU Delegated Regulation, was to legislate to require anti-tampering devices and a unique identifier encoded with a 2D matrix code on each pack of prescription only medicine. The intention was to verify these at points throughout the supply chain to prevent falsified medicine in the supply chain.

The IA states that the that the rationale for intervention is that falsified medicines present a threat to public health in the form of adverse reactions, dangerous ingredients, interaction with other medicines, no improvement in health conditions, a disincentive to take prescribed medicines and a loss of faith in healthcare systems. The RPC suggested that the IA could be more explicit about the primary rationale for the measure, which was that it is required by an EU directive, and providing greater clarity on the underlying merits of the measure to the UK, given that the information in the IA seemed to imply that benefits were highly unlikely to match costs.