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**IMPACT ASSESSMENT IN THE
EUROPEAN COMMISSION:
QUANTIFYING BENEFITS AND COSTS**

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IMPACT ASSESSMENT IN THE EUROPEAN COMMISSION: QUANTIFYING BENEFITS AND COSTS

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1. Introduction

Impact Assessment (IA) is now firmly established in most OECD countries as an integral part of the policy appraisal and evaluation process. In the European Commission, impact assessment is applied to all items on the Commission's Work Programme, covering regulatory proposals, White Papers, expenditure programmes and negotiating guidelines for international agreements. In addition, the Commission may decide, on a case by case basis, to carry out an impact assessment of a proposal which does not appear on the Work Programme. In June 2005, the Commission issued new Impact Assessment Guidelines, which explained the importance of impact assessment in the following terms:

‘It ensures early coordination within the Commission. It demonstrates the Commission’s openness to input from a wide range of external stakeholders, and shows its commitment to transparency. Further, by providing a careful and comprehensive analysis of likely social, economic and environmental impacts, both direct and indirect, it also contributes to meeting the specific commitments of the Lisbon and Sustainable Development Strategies. Also, it improves the quality of policy proposals, by keeping EU intervention as simple as possible. Finally, it will help explain why an action is necessary and that the proposed response is an appropriate choice or, conversely, demonstrate why no action at EU level should be taken’ (EC 2005a:5)

How successful have the Commission’s impact assessment procedures been in meeting these objectives? The Commission’s impact assessment studies have been evaluated in a number of recent publications.¹ Most have evaluated formal compliance with the individual elements of the RIA procedures and process. Compliance testing typically involves a ‘scorecard’ assessment against a benchmark for good practice. Lee and Kirkpatrick (2006), Vibert (2004), Wilkinson et al (2004), Renda (2006), Opoku and Jordan (2005), IMV(2006), and Franz and Kirkpatrick (2006) all provide compliance evaluations of impact assessment reports produced between 2003 and 2006. In general, the results of these studies identify a process of ‘learning by doing’ with gradual improvement in the quality of the reports occurring over time. They also draw attention to a number of specific weaknesses in the reports. Lee and Kirkpatrick (2006), for example, highlight weaknesses in terms of problem identification, narrowness in the range of policy options covered, and unbalanced coverage of different types of impacts. Franz and Kirkpatrick (2006) evaluate a sample of reports produced using the new IA Guidelines that were introduced in mid 2005, based on their inclusion of sustainable development considerations in the assessment analysis. The results of the evaluation indicate the treatment of sustainable development is uneven, with limited quantification of benefits and costs.

This paper contributes to this body of evaluation literature by extending the evaluation of EC IA beyond formal compliance to an evaluation of the quality of the analysis undertaken.² It focuses on the specific issue of the quality of the analysis contained in the Commission’s reports and asks the question: how successful has the Commission been in ‘providing a careful and comprehensive analysis of likely social, economic and environmental impacts, both direct and indirect...(and)...meeting the specific commitments of the Lisbon and Sustainable Development Strategies’ (EC, 2005a)? It identifies a number of analytical weaknesses and then proceeds to a detailed discussion of how the quality of the analysis might be improved and strengthened, particularly in the quantification of impacts.

¹ The Commission has also commissioned a evaluation study of its impact assessment work, see, EC(2006a).

There are six sections to the paper. This introduction is followed by a summary of the role of impact assessment in achieving sustainable development goals for all new policies proposed within the EC and specifically the role of the IA system in supporting the design and implementation of better regulation. Section three outlines what is involved in IA and how the likely consequences of various policy options are traditionally estimated. Weaknesses of two related aspects of the impact analysis are also addressed: the treatment of the three ‘pillars’ of sustainable development and the quantification of impacts; this section introduces the need for improved methods of quantification and thus a more holistic approach to quantifying social, environmental and economic impacts. Section four introduces the role of cost-benefit-analysis as a framework in which non traditional costs can be more thoroughly considered in IA. The tools available under this framework allow the improved quantification of impacts which traditionally have no value or price readily tradable on traditional markets; both the advantages and disadvantages of cost-benefit analysis in IA studies are outlined. Section five discusses measures that could facilitate the greater use of economic valuation and cost benefit analysis in the EC’s impact assessment work and Section six concludes.

2. The Goal of Impact Assessment

Both ex ante appraisal and ex post evaluation depend on a clear understanding of the end-goal or objective of the intervention that is being assessed and the purpose of the impact assessment itself.³

The introduction of impact assessment procedures in the Commission can be linked back to the 2001 Goteborg European Council meeting which stated that ‘sustainable development should become the central objective of all sectors and policies....Careful assessment of the full effects of a policy proposal must include estimates of its economic, environmental and social impacts inside and outside the EU’ (EC, 2001a). The 2002 Communication on Impact Assessment (EC, 2002a) reproduced the above quotation on the front cover, and explained that the impact assessment procedures were intended to ‘contribute to an effective and efficient regulatory environment, and further, to a more coherent implementation of the European strategy for Sustainable Development’.

A closely related Communication, issued at a similar time to the announcement of the impact assessment system, was the Action Plan for Simplifying and Improving the Regulatory Environment (EC, 2002c) which identified the impact assessment system as one action within the Better Regulation Action Plan. Starting with the White Paper on European Governance (July 2001) and the Better Lawmaking Action Plan (June 2002), the EU has pursued a broad strategy to provide a more effective, efficient and

² Sometimes referred to as performance testing. Evaluation can also be conducted in terms of outcomes of the policy intervention. For a discussion of evaluation procedures and measures, see Ladegaard (2007) and Radaelli and De Francesco (2007)

transparent regulatory system. The impact assessment system is seen as supporting the design and implementation of ‘better regulation’, by ensuring that ‘new legislation is well prepared, proportionate, respecting the subsidiarity principle, and is not overly complex or burdensome in its implementation provisions’ (EC, 2006a). The most recent Communication on ‘A Strategic Review of Better Regulation in the European Union’ describes the objective of the Better Regulation Programme in the following terms: ‘The European Union aims at fostering a regulatory environment which protects citizens while supporting European businesses to compete more effectively and be more innovative in a highly competitive global environment’ (EC, 2006b:4).

There are two main political drivers, therefore, behind the Commission’s impact assessment procedures: the EU’s Sustainable Development Strategy and its call for measures to increase policy coherence between the economic, social and environmental dimensions; and the Better Regulation agenda, which calls for initiatives to promote effective and efficient regulation as part of the efforts to fulfil the Lisbon objectives of a competitive European economy.

One way of viewing the relationship is in terms of a hierarchy of objectives, where sustainable development is the ultimate goal or ‘end’ for all policy initiatives, and a more competitive economy is a means of accelerating progress towards that goal.⁴ This perspective is reflected in the Communication on the 2005 Review of the EU Sustainable Development Strategy (EC, 2005b):

‘The Commission in proposing the Strategic Objectives for the Union over the next five years has reaffirmed its commitment to sustainable development. It has just proposed in the mid-term review of the Lisbon Strategy to make a renewed Lisbon agenda our strategy for growth and jobs: allowing us to use the motor of a more dynamic economy to fuel our wider social and environmental ambition. In this way, Lisbon remains an essential component of the overarching objective of sustainable development set out in the Treaty: improving welfare and living conditions in a sustainable way for present and future generations. As the Commission affirmed in the mid-term review, both Lisbon and the Sustainable Development Strategy continue to ensure this goal. Being mutually reinforcing, they target complementary actions, use a range of instruments and produce their results in different time frames.’⁵

³ EC (2004) states that ‘In 2002, the Commission introduced a new Impact Assessment procedure designed to contribute both to an effective and efficient regulatory environment and to a more coherent implementation of the Sustainable Development Strategy’ (:3)

⁴ The 2005 IA Guidelines identify a three level hierarchy of objectives (i) general objectives which are the overall goal of the policy and are expressed in terms of its ultimate outcome or impact (ii) specific objectives which are the immediate objectives of the policy- the targets that first need to be reached in order for the general objectives to be reached (iii) operational objectives which are normally expressed in terms of outputs – goods or services that the intervention should produce (2005a)

⁵ This assumes that the competitiveness and sustainable development goals are given equal weight in the IA and that trade offs do not arise.

The Communication on Better Regulation for Growth and Jobs in the European Union (2005c) also affirms the Commission's commitment to integrated impact assessment based on the principle of sustainable development and is designed to allow policymakers to make choices on the basis of careful analysis of the potential economic, social and environmental impacts of the new legislation: 'This integrated approach is based upon the principle of a thorough and balanced appraisal of all impacts and allows the presentation of a comprehensive analysis and the identification of trade-offs, where relevant' (EC, 2005c:5).

Europe's sustainable development goal is reflected in the current Guidelines, where the analyst is expected to assess potential impacts across the three policy dimensions – economic, social and environmental – as well as the potential tradeoffs and synergies.⁶

3. Assessing Impacts

The analysis of impacts involves the estimation of the likely consequences of the policy option that is being assessed. The results of the analysis need to comply with the standards of 'good science'⁷ while at the same time being accessible and transparent to non-specialists. The IA methodology uses *causal chain analysis* to track the initial impact of the policy intervention through to its final impact on the goal(s) of the intervention. This final impact is reported in terms of *indicators*, which record the *significance* of the *positive and negative* impacts.

The Guidelines provide guidance on these basic components of the IA methodology. There is a discussion of the use of a 'causal model' and flow charts to sketch out the cause and effect linkages between the policy proposal and its impacts, and an acknowledgement that 'what is important is that those involved in the process of drawing up the model are agreed that it represents a sufficiently accurate and explicit image of impacts and their causes...' The Guidelines refer to (but do not provide details) a set of sustainable development indicators, and recommend use of these indicators on the grounds of ensuring compatibility of impacts between different proposals.⁸ It is recommended that the significance of the impacts assessed in terms of likelihoods (e.g. low, medium or high probability) and magnitude (i.e., low, medium or high). The Guidelines also recommend that the initial analysis of impacts should be in qualitative terms, but when it is considered proportionate, further quantitative analysis may be appropriate.

It should be acknowledged that the EC's adoption of an assessment framework, rather than a rigidly prescriptive methodology, is consistent with the IA approach being used in most member states. As a

⁶ The IA is also required to assess international impacts.

⁷ See Ballantine (2005)

⁸ EC (2005d) provides a set of SD indicators to monitor the implementation of the EU Sustainable Development Strategy.

consequence, there is significant variety in the character of the assessments undertaken, both within the Commission and between different national systems.⁹ IA is a tool for improving the quality of public policy choices by providing decision-makers with credible and robust evidence on the likely consequences of alternative policy options. It is a tool, therefore, for decision-making rather than a decision making tool, and is part of the broader shift toward evidence-based public management reform. Equally, the good governance dimensions of impact assessment which emphasise consultation, transparency and accountability with stakeholders contribute to better policymaking. Recognition of these characteristics of impact assessment should be allowed for in the evaluation of IA. In particular, it would be a mistake to evaluate the quality of impact assessment solely in terms of the analytical 'rigour' of the assessment reports.

We now turn to an evaluation of the quality of the analysis in the Commission's impact assessments. The discussion is focused on two issues: the treatment of the three 'pillars' of sustainable development (i.e., economic, social and environmental), and the quantification of impacts. Both of these issues have been identified by the Commission itself and by external evaluators as weaknesses in many of the IA reports that have been prepared by the Commission.

The uneven treatment of economic, social and environmental impacts has been identified as an important limitation of EC impact assessment reports. Wilkinson et al. (2004) evaluated a sample of reports prepared in 2003 and found that the assessment of impacts across the three pillars of sustainable development was uneven, and of the 15 IAs with relevance to all three elements of sustainable development, only about one third actually addressed all three; and even then with marked differing degrees of detail. Social impacts were generally afforded the least attention and international impacts were rarely referred to. Analysis of environmental impacts was limited compared to economic factors and none of the assessments explored in any detail the trade-offs between different SD considerations.

The study by the Environmental Assessment Institute (IMV, 2006) analyses IAs carried out during the period from 2004 to September 2005. Detailed examination of the distribution and number of impacts showed that in 29 of the 58 IAs, environmental impacts are not covered at all. Similarly, six do not cover economic impacts and six do not include social impacts.

Franz and Kirkpatrick (2006) evaluate 13 Impact Assessments produced since the introduction of the new IA Guidelines in August 2005. Of the 13 IAs assessed, nine are Communications, two Decisions, one Action Plan and one Directive. As with previous evaluations of this nature, it was found the coverage across the three pillars of sustainable development was uneven. Economic impacts received the greatest attention, with 10/13 IAs giving some consideration to economic impacts and 9/10 giving medium to high coverage. Social impacts received slightly less attention, with 9/13 IAs addressing social issues.

⁹ The OECD concluded that this complicates the task of comparing and monitoring IAs across

Environmental impacts received the least attention with only 5/13 giving any consideration to an environmental component and only 3 of the 5 in significant detail.

A major weakness is the limited quantification of impacts. Franz and Kirkpatrick (2006) for example found that only three of the thirteen IAs in their sample attempted quantification of economic, social and environmental impacts. Where quantification is used, it is often presented in terms of different units of measurement which are not comparable with each other.

The related issues of 'balance' and 'quantification' are referred to in the Communication on Better Regulation for Growth and Jobs in the European Union (EC, 2005c), where the Communication reaffirms the Commission's commitment to integrated impact assessment based on the principle of sustainable development and designed to allow policymakers to make choices on the basis of careful analysis of the potential economic, social and environmental impacts of the new legislation: 'This integrated approach is based upon the principle of a thorough and balanced appraisal of all impacts and allows the presentation of a comprehensive analysis and the identification of trade-offs, where relevant' (EC, 2005c:5). However, the Communication goes on to state that:

“While the existing impact assessment tool provided a solid basis, the Commission believes that the assessment of economic impacts must be strengthened so as to contribute to the objectives of the renewed Lisbon strategy. Deepening the economic pillar of impact assessment does not compromise the importance of 'sustainable development' and the integrated approach, which remains the basis of the Commission's approach. Deepening the economic analysis, which also includes competitiveness aspects, should improve the quality of the assessment of the true impact of all proposals. This will therefore, make a significant contribution to strengthening competitiveness including effective competition while continuing to properly assess social and environmental consequences of proposed measures” (EC, 2005c:5).¹⁰

Major revisions to (regulatory) impact assessment, including increased emphasis on the quantification of social and environmental costs and benefits, are therefore required.

time and across departments (OECD, 2002)

¹⁰ Similarly, the UK the National Audit Office report on Regulatory Impact Assessment and Sustainable Development found that 'wider issues were often not considered with rigour' and on considering sustainable development in RIAs, 'that few of them identified and analysed Sustainable Development to a sufficient level' (NAO, 2006). However, in contrast to the EC response, the Cabinet Office has proposed increased emphasis on the quantification of *social and environmental* costs and benefits. The UK government has also proposed changing the name from 'regulatory impact assessment' to 'impact assessment to better reflect the objective of encouraging policymakers to consider alternative approaches to policy solutions and to continue to monitor and manage costs and benefits beyond legislation into implementation. (Cabinet Office, 2006)

4. Quantification of Impacts and the Role of Cost Benefit Analysis

In this section, we explore the potential for increased quantification in impact assessment, and in particular, the role of cost-benefit analysis. Before doing so, however, it is necessary to clarify the terminology being used in this context. *Quantification* is defined as the measurement of the quantity or amount of something, but does not specify the unit of volume or amount. *Financial* analysis refers to the money value of impacts (positive and negative) as expressed in market transaction values. *Economic* analysis refers to the economic value of positive impacts (benefits) and negative impacts (costs) as measured by an individual's willingness to pay (or accept) valuation.¹¹

The major advantage of quantifying impacts in economic (or financial) terms is that it uses a common unit of measurement, allowing different impacts to be compared in relative terms. If all benefits (positive impacts) and costs (negative impacts) can be quantified in economic terms, economic cost benefit analysis (commonly referred to as cost benefit analysis, or CBA), would provide the 'magic bullet' for solving the problems of 'balance' and 'quantification' in impact assessment. But the reality is that CBA, like any other analytical tool, has advantages and disadvantages when applied as a means of quantifying impacts. It is important to appreciate these factors when considering the usefulness of CBA in impact assessment. The following discussion highlights, therefore, the potential gains and problems of applying cost-benefit analysis in the quantification of economic, social and environmental impacts.

What is cost-benefit-analysis?

Cost-benefit analysis (also referred to as Benefit/cost analysis or BCA) is a technique based on welfare economics that examines the present value of economic benefits and costs of an activity or project over some defined period of time. Growing economic costs of regulation have led to the widespread use of tools to compare the costs vs. the benefits of proposed policies (Arrow, Cropper et al. 1996). CBA is a set of tools that uses shadow prices (or economic scarcity values) where market values are absent and/or government intervention or failure has caused distortions in the market place. The tools developed in CBA therefore provide useful mechanisms to value social and environmental impacts in economic terms. In the context of IA exercises, CBA is one approach to improving the valuation of likely consequences of policy options, where market prices are otherwise unavailable. In a seminal piece on the role of CBA, Arrow et al. (1996) argued:

“Benefit-cost analysis is useful for comparing the favorable and unfavorable effects of policies...and can help decision-makers better understand the implications of decisions by

¹¹ A further classification issue arises with the Standard Cost Model approach to assessing regulatory impact, where the analysis is in terms of private sector administrative compliance costs only.

identifying and quantifying the favorable and unfavorable consequences of a proposed policy change, even when information on benefits and costs is highly uncertain.” (p. 221)

Although there are many uncertainties involved in quantifying environmental and social impacts of policies, there is a clear role for CBA in helping agencies and decision-makers to set regulatory priorities. Nonetheless, valuing impacts of policies on social and environmental welfare in terms of monetary gains or losses presents a number of theoretical as well as moral hazards.

Direct and Indirect Valuation

In valuing environmental and social impacts of policies, there are two broad categories of valuation techniques in practice: direct and indirect valuation (Kirkpatrick, 2000). Direct valuation is used to elicit preferences by experiments or questionnaires and the most common method is contingent valuation (CV). This approach uses both the willingness to pay (WTP) to have a defined gain (benefit) or to avoid a damage (a cost); and the willingness to accept (WTA) compensation to forgo a gain or tolerate a cost.

Indirect methods of valuation utilise actual market based information and include techniques such as hedonic pricing and wage techniques; travel cost methods and dose-response techniques. Indirect valuation avoids many problems inherent to direct valuation such as strategic, information and hypothetical biases, where respondents' answers are bias in favour of a particular outcome and/or limited information can alter true preferences (Tietenberg 2004). Indirect methods of valuation can also be based on contingent ranking of stated preferences.

Applying CBA to environmental impact valuation

Increased regulatory activity has highlighted the relationship between environmental concerns and market activities (Helm and Pearce 1998). Cost-benefit analysis has been widely developed in the field of environmental economics as it provides a framework in which economic insertions into the environment can be valued. The various techniques offered under CBA provide a means of placing “valuations on environmental assets and consequences to develop appropriate policies” (Helm and Pearce, 1998). Environmental externalities in particular present unique difficulties for IA where policies should be approved or rejected based on their achieving economic, social and environmental welfare for present and future generations. Traditional property rights do not hold when markets are absent; with respect to environmental services, ownership of resources is not readily divisible or possible and/or impacts contained to a single area. Furthermore, with respect to the wider impact of resource use on the natural environment, imperfect information exists in the context of long-term impacts of pollution on ecological as well as human health, and, therefore, presents a fundamental challenge to sustainability goals where future benefits and impacts must be considered alongside the present. Although imperfect, CBA encompasses a series of tools to establish a common value of externalities which are ignored in traditional accounting thereby allowing these “goods” to be “traded” on established markets. For example, carbon trading is now widespread in Europe and a primary example of successful CBA which established a

market for otherwise “priceless” goods, i.e. the negative environmental impacts of carbon emissions. In this case, the precautionary principle was employed illustrating the role of CBA in establishing the benefits of acting under uncertainty to avoid potential costs of inaction, i.e. not reducing carbon emissions. In such a scenario, CBA proves to be useful in providing a framework for considering gains from such “cooperative solutions (Helm and Pearce 1998). Emissions charges in terms of water and air are commonly used throughout Europe and are another example of CBA being used in determining the charge rate in terms of environmental and economic costs. CBA therefore provides a forum for establishing the costs of the polluter and thus forcing compensation for potential or actual damages.

Applying CBA to social impact valuation

Qualitative estimations of social welfare are well developed in the economic literature (Clarke and Islam 2003). Quantitative measures of social welfare are less well established. Adjusted values of traditional welfare measures have been proposed to account for these difficulties, such as adjusted GDP as a social welfare function (Clarke and Islam 2003). However, just as GDP is a poor measure of welfare in terms of environmental accounting, in order for GDP to be an appropriate measure of social welfare, it would have to incorporate the costs and benefits of economic activity in relation to social domains, including poverty, income distribution and inter-generational issues (Sen, 2006). Estimating potential impacts of policies on social welfare is a primary aim of regulation, therefore, in terms of social gains and losses, impact assessment can, in principle, benefit from the tools common to CBA studies. Social (poverty) impact measurement involves the choice and quantification of a welfare indicator and a means of discriminating between different groups in society. Traditionally, CBA analysis has been concerned only with the net gain in economic welfare, and assumed that the losers can be compensated by the gainers. The CBA methodology was subsequently adapted to allow for distributional weights to be attached to the benefits and losses incurred by different income groups (i.e. lower income groups receive a higher weight), where the weights are derived from an estimate of society’s social welfare function (Curry and Weiss, 2000). But the problems of determining the distributional weights have meant that this approach has seldom been applied in practice. The alternative approach is simply to estimate how the change in economic welfare is distributed between different groups. However, the choice of the economic welfare ‘metric’ as a measure of welfare continues to be criticised for its inability to capture the multidimensionality of welfare (Dercon, 2006).

Advantages of CBA in IA

With respect to the three pillars of sustainable development, satisfying the criteria proposed in all IAs to incorporate economic, social and environmental impacts is a distinct challenge. Identifying the economic impacts of policies where prices or markets are absent is necessary to ensure all three pillars are adequately quantified and considered in IAs and thus sustainable development criteria can be accurately assessed. IA is fundamentally challenged by the need to quantify various social and environmental factors linked to policy proposals in terms of economic costs and benefits. Traditional quantification exercises which do not consider the non-market costs in terms of environmental and social capital will

inherently undervalue the costs incurred by any proposed policy change thereby reducing overall social, economic and environmental welfare.

Although imperfect, CBA can help policy makers identify the optimum level of regulation. The role of CBA is therefore to “illuminate” when the costs of regulation exceed the benefits of that regulation, therefore, understanding the marginal costs associated with regulatory policies and identifying the “winners and losers” when aggregate benefits exceed aggregate costs (Arrow, Cropper et al. 1996).

As regulatory bodies performing IAs incorporate the tools of CBA and improve their use and dissemination, a comparison of values and findings will be facilitated. In the absence of alternative methods of quantifying non-market goods, the existing CBA tools provide a well-tested framework in which to offer decision-makers estimated costs, even if imperfect, on social and environmental well-being, and thus a more accurate picture of the economic costs or benefits of a proposed change to policy or introduction of new legislation. Through the use and development of CBA in such an arena, the methods will improve and the application of results will widen, thus reinforcing the development of such quantification methods in all IAs. Therefore, although, CBA can not be viewed as “sufficient” for designing public policies, it can provide “an exceptionally useful framework for consistently organising disparate information...and thus can greatly improve the process and outcome of policy analysis” (Arrow, Cropper et al. 1996).

Disadvantages of CBA in IA

Any attempt to value non-market externalities, such as biodiversity, happiness and/or health over one’s lifetime, presents many methodological as well as moral problems. With respect to VSL estimations, placing monetary values on human life is a controversial aspect of policy analyses as regulators are under increased pressure to look at the costs and benefits of policies on health. CBA requires some form of monetary valuation for comparison purposes and such values are often based on “best study” approaches as data are often limited and studies not widely applicable across populations and varying levels of economic development (Johnson, Fries et al. 1997). Valuation techniques can likewise ignore important distributional effects, i.e. in countries with highly skewed income distribution, valuation studies may not adequately consider such inequality. For example, the WTP or WTA certain externalities associated with air pollution may vary depending on unemployment rates within a certain country. Likewise, in areas with higher incomes, CV studies may misrepresent preferences across a society, e.g., existence value of environmental goods (Rietbergen-McCracken and Abaza 2000). Discount rates are likewise a problem with CBA studies, for example, where those being questioned prefer present use over future use, the discount rate becomes very important in terms of the sustainable use of a good. Pearce and Moran (1994) argued that instead of lowering discount rates, efforts to improve valuation techniques should be made to improve estimations of future costs and benefits. There are numerous issues with CBA studies linked to the transferability of findings from one country, population, set of resources, to another. Values based on CV are also problematic as conditions will vary in other contexts and thus values will vary under different

conditions. Direct valuation methods in terms of social welfare have been argued against due to limited data and information on important aspects of well-being, such as distribution of services and income. Some social goods, such as freedom and leisure, are poorly captured in CBA as individuals cannot make choices about situations and circumstances they cannot directly experience or imagine (Sen 1985). With respect to the valuation of environmental goods and services, the many problems facing CBA are not sufficient to justify avoidance of quantification all together and particularly in environmentally sensitive projects (Pearce and Moran 1994). Therefore, although CBA tools are problematic, the alternative of no valuation of any kind of non-market goods does not bring policy makers and institutions any closer to ensuring sustainable development goals are met.

5. Incorporating CBA in Impact Assessment

At a practical level, the use of CBA ensures that consideration is given to the potential benefits as well as the costs of the policy proposal.¹² Traditionally, cost benefit analysis has been used as a decision making tool, where the project or proposal is recommended for adoption if the total economic benefits exceed the total economic costs. While we endorse greater use of economic valuation of costs and benefits in impact assessment, we do not advocate the strict application of the 'positive net benefit' rule for decision making. The reasons were discussed in the preceding section and need only be summarised. First, not all impacts can be quantified in economic terms. There is a danger, therefore, that quantitative factors will crowd out qualitative factors. Second, CBA typically provides 'single point' estimates which do not allow for risk and uncertainty. Third, CBA focused on aggregate net economic impact and cannot easily accommodate distribution ('who gains and loses?') concerns.

To repeat a point made earlier, IA is a process for better decision making in the public sector. It should not be seen as a mechanical exercise or a formulaic approach to problem solving. Rather, it involves judgements being made in a transparent and accountable manner, based on the best available evidence. Greater use of CBA can contribute to the strengthening of the evidence base for impact assessment and better policy making provided that it does not reduce attention given to other non-quantified evidence. As Weiss (2006) observes:

'...there may be effects that defy sensible quantification (so called 'intangibles'); for example, impact on wildlife, on community lifestyles or on culture. CBA should not attempt to measure the intrinsically immeasurable and should set out both tangible quantifiable effects and a description of other intangible consequences. The ultimate decision takers can then make their own subjective trade-offs between these'.

¹² Cost effectiveness analysis takes the benefits as given, and assesses the least cost method of achieving the given objective.

There are a number of practical measures that could facilitate the greater use of economic valuation and cost benefit analysis in the EC's impact assessment work:

- The Impact Assessment Guidelines should be revised to give fuller guidance on the use of CBA in the analysis of impacts.
- The goal of ensuring that benefits outweigh costs should be emphasized, although this may entail judgments of the relative importance of different types of impact, and of qualitative as well as quantitative considerations. This could be integrated into the procedures by following the UK practice, which requires a Ministerial 'sign-off statement that 'I have read the Impact Assessment and I am satisfied that the benefits justify the costs'. In the recent consultation on revising the RIA, it was proposed to add an additional 'sign – off' statement from the sponsoring Department's Chief Economist: 'I have read the Impact Assessment and I am content the evidence base supports the proposed costs, benefits and impact of the policy options' (Cabinet Office, 2006). The inclusion of this second declaration is seen as a means of improving the quality of the analysis.
- Good quality IA relies on those involved in the process understanding its rationale and practical application. This involves familiarization with both CBA and other aspects of IA which in turn will have implications for staff training and development.
- The recently established Impact Assessment Board (IAB), composed of high level officials, acts independently of the policymaking departments and reports directly to the President (EC, 2006). Its role is to offer advice and support in developing a culture of impact assessment within the Commission, and providing quality advice while ensuring that responsibility for preparing assessments and the relevant proposals remains with the relevant departments and Commissioners.

The IAB could support the diffusion of CBA good practice in a number of ways:

(i) carry out regular evaluations of the IAs and highlight good and bad practice in the economic valuation of benefits and costs and identify appropriate and inappropriate uses.¹³ The evaluation reports of the IAB should be placed in the public domain, to enhance transparency and accountability.

(ii) consider the case for the IAB taking responsibility for determining the economic values of key parameters used by the departments and Directorates in preparing IAs. These values could include the value of the discount rate, the value of human life and pollution values.¹⁴ This would ensure consistency across impact assessments and facilitate cross comparisons.

¹³ The UK National Audit Office's regular evaluations of the RIA provide an example of using evaluation to support quality improvement (NAO, 2006).

¹⁴ Hahn and Litan (2005) identify the non-standardisation of federal agencies' estimates of economic costs and benefits as a major weakness in the United States Office of Management and Budget (OMB) estimates of the total costs and benefits of regulation.

6. Conclusions

The introduction and systematic use of impact assessment in the European Community has provided the opportunity to improve the quality of European governance. Since the adoption of IA in 2001, there has been significant progress in refining both the theory and practice of impact assessment within the Commission. At the same time, however, evaluations of the IA process have revealed weaknesses in its application, and have highlighted a number of areas where quality could be improved.

This paper has identified two main areas of weakness, relating to the treatment of social, economic and environment impacts in a way that is consistent with the Commission's sustainable development objective, and to the quantification of impacts. It has made a number of recommendations that are intended to strengthen the quality of analysis in impact assessments, particularly in the use of quantitative analysis. It has also emphasised, however, the need for both quantitative and qualitative analysis, to avoid giving undue weight to quantified impacts and to ensure that a 'balanced' treatment is given to all three pillars of sustainable development.

More generally, it is important to guard against allowing IA to operate in a silo. If it is to contribute to Europe's sustainable development and competitiveness goals, impact assessment needs to continue to be part of a wider process of regulatory reform and better governance, aimed at increasing transparency and accountability. Also, it is important to maintain the momentum towards building an effective IA management system with support for the process at the highest political level. The establishment of the Impact Assessment Board is an important and welcomed signal across the Commission of the importance of the IA process. Provided that it operates in an independent, transparent and accountable manner, it should help protect IA from 'capture' by civil servants who may wish to use impact assessment to promote their own or department's agendas, or by external interest groups.

The current stage of IA development within the Commission presents both opportunities and dangers. If expectations greatly exceed reality IA could come to be regarded as a passing fashion in public administration.¹⁵ This could be followed by disillusionment and ultimately rejection of the concept. To avoid this, we need to commit to an ongoing process of evaluation which provides practical proposals for addressing the difficulties that IA faces in embedding itself in the Commission's public management system and procedures.

¹⁵ Parker (2006) makes the same point in his assessment of RIA in the UK.

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